The New York Certified Public Accountant

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The NEW YORK CERTIFIED PUBLIC ACCOUNTANT *is published monthly from October to June. Copies may be obtained at the office of the Society at twenty-five cents per copy, $2.00 per year. All other communications relating to this publication should be addressed to the Committee on Publications.*

CURRENT EVENTS

Calendar of Events

March 18—Regular Meeting of the Board of Directors.

March 18—7:45 P. M.—Society Meeting — Subject: Commercial Arbitration—Location: Waldorf-Astoria Hotel, Lexington Avenue at 49th Street, New York City.

April 3—8 P. M.—Special Technical Meeting—Subject: Intangible Assets—Location: Engineering Auditorium, 29 W. 39th Street, New York City.

April 4—Regular Meeting of the Board of Directors.

April 8—7:45 P. M.—Society Meeting—Subject: To be announced later—Location: Waldorf-Astoria Hotel, Lexington Avenue at 49th Street, New York City.

April 10—8 P. M.—Special Technical Meeting—Subject: Real Estate Accounting—Location: Engineering Auditorium, 29 W. 39th Street, New York City.

April 17—8 P. M.—Special Technical Meeting—Subject: Mining and Smelting Accounting—Location: Engineering Auditorium, 29 W. 39th Street, New York City.

April 24—8 P. M.—Special Technical Meeting—Subject: Governmental Accounting—Location: Engineering Auditorium, 29 W. 39th Street, New York City.

Legislation

A special meeting of the Society was held at the Waldorf-Astoria Hotel on the evening of March 11, 1940, for the purpose of consideration of the Steingut Assembly Bill, Int. No. 863, Print No. 2060, to regulate the practice of public accountancy, which is essentially the same as the bill in the Legislature at the close of the session in 1939. Following a general discussion by the members, a motion was passed authorizing the Legislation Committee to inform the Legislature of the approval of the bill by the Society and to take appropriate steps to secure the enactment of the bill.

March Meeting of Society

On March 18th was held the first monthly meeting of the Society since January, conducted by the Committee on Commercial Arbitration. The principal speaker of the evening was Mr. Edward J. Noble, Under Secretary of Commerce, who delivered an interesting address on "A Balance Sheet for Latin American Trade".

Mr. Franklin E. Parker, Jr., President of the American Arbitration Association and a member of the New York Bar, spoke on "Arbitration in Action", and Mr. Martin Kortjohn, a member of the Society, gave a talk on "The Accountant's Place in Arbitration".

James F. Hughes

An announcement from the American Arbitration Association has been received to the effect that Mr. James F. Hughes, past president of the Society, and chairman of the Society's Committee on Commercial Arbitration, has accepted appointment to the Board of Liaison Officers of "1940 Arbitration Year in the Americas". The purpose of this organization is "to dramatize the practice and principles of arbitration as a means of maintaining and fostering commercial peace and goodwill in the western hemisphere", as stated by the Association.

New York Credit Men's Annual Dinner

The Society's Committee on Co-operation with Credit Men was represented at the annual dinner of the New York Credit Men's Association on March 7th at the Hotel Astor, the principal speaker being the president of the Canada Dry Corporation. Messrs. Loeb (Chairman) Byerly, Heaton, Marvin, Rea, and Peyser of the Committee, and Messrs. Gantt and Welsh of the Society's staff were present.

Special Technical Meetings

The Spring series of special technical meetings, for members only, formerly known as round-table forums, will be held on Wednesday evenings at 8 P. M., in the Engineering Auditorium, 29 West 39th Street, New York City, starting on April 3rd and ending May 8th, on the following subjects:

April 3rd—Intangible Assets—T. Reginald Cloake, Chairman

April 10th—Real Estate Accounting—Allan C. George, Chairman

April 17th—Mining and Smelting Accounting—Crawford C. Halsey, Chairman

April 24th—Governmental Accounting—Everett J. Penny, Chairman

May 1st—Dairy Industry Accounting — Chester W. De Mond, Chairman

May 8th—Foreign Trade Accounting—George W. Price, Chairman

Reservation card has been sent to the members covering the meetings for April 3rd and 10th and members wishing to attend these meetings should notify the Society's office. Reservation card for the balance of these meetings will be sent to the members with other notices.

Address by Member

On February 29th Mr. J. S. Seidman, member of the Society's Committee on Federal Taxation, gave an address before the Pace Institute Forum on "The Significant Features of 1940 Federal Income Taxes." Mr. Seidman took the occasion to point out several notable changes which, in his opinion, would be made in the Federal Tax laws this year in order to create additional revenue. Among these were a reduction in the rate of personal exemptions, a possible curtailing of the issuance of tax exempt securities, and the new methods of figuring inventories in corporate returns.

The demand for seats at the original meeting was so great that Mr. Seidman kindly agreed to repeat the same address a week later for the benefit of those who were unable to be present on February 29th.

Murdoch W. Maclachlan

Murdoch W. Maclachlan, a partner of the firm of Peat, Marwick, Mitchell & Co., died on February 18th, after a long illness at the age of 58. He was a member of the Society since October, 1931.

Mr. Maclachlan was active on various committees of the Society and was a member of several other organizations.

He is survived by his widow and daughter.

The Society has suffered a great loss in the passing of this valued and esteemed member.

RECENT PUBLICATIONS

ACCOUNTANCY AS A CAREER. By Lawrence W. Scudder, C.P.A., Funk & Wagnalls—New York, 1939. 161 pages, $1.50.

This easily read volume describes for the uninitiated, who may have thoughts in the direction of accountancy, just what it is all about. Starting with the importance of background and qualifications, the author, who is an experienced certified public accountant, outlines the work of the accountant, his increasing importance to industry today, and some of the outstanding roles played by members of the profession since the turn of the century. One of the most interesting chapters tells the story of Ivan Krueger, Coster, and Samuel Insull, and shows how public accountants aided in unravelling the intricate operations of these men. Those seriously considering accountancy as a career will appreciate those chapters in which the author takes up the future of the profession, earnings possibilities, and the question of supply and demand for public accountants as compared with other leading professions.

This volume is one of the Kitson Career Series under the editorship of Prof. H. D. Kitson of Teachers College, Columbia University.

DO YOU WANT TO BECOME AN ACCOUNTANT. By Thomas W. Byrnes and K. Lanneau Baker. Frederick A. Stokes & Co., 1940. 189 pages, $1.50.

Another book for those who are thinking of taking up accounting as a career. It is written, as the authors frankly state, "to attract to a fascinating career those who possess the aptitude for it, and only those . . . " In presenting their argument Messrs. Byrnes and Baker, who are on the teaching staff at Columbia as well as being practicing accountants, cover the ground thoroughly, from a short history of the profession to the opportunities that exist therein for young people today. Between these two points are found some very interesting chapters, which take up the actual work of an accountant as he progresses from junior on up, to training required, and the professional ethics involved. A section is also devoted to the C.P.A. examinations with the various methods of preparing for them, and the volume closes with a dissertation on the future of accountancy.

There is also included an interesting letter written in 1820 by Sir Walter Scott, recommending the accounting profession as a solution to the career of his nephew, in which he points out that "If my nephew is steady, cautious, fond of a sedentary life and quiet pursuits, and at the same time proficient in arithmetic, and with a disposition towards the prosecution of its highest branches, he cannot follow a better line than that of an accountant." A profound observation, still worthy of consideration 120 years later!

The appendix contains a list of the approved schools of accountancy compiled by the Education Department of New York State, the different state qualifications for C.P.A. certificates with addresses of the State Boards, and a description of the chartered accountants in Canada.

PRENTICE-HALL NEW YORK TAX COURSE (Including Other Miscellaneous Taxes) Edition A. Prepared by the Editorial Staff of Prentice-Hall, Inc. in collaboration with Stanley B. Tunick. Prentice-

Hall, Inc., New York, 1939. 1096 Pages. $4.40.

For many years, instructors in tax courses dealing with the various miscellaneous (i.e., other than incomes) taxes have been seriously handicapped in their work by reason of the fact that text materials in a form suitable for convenient classroom use have not been available to their students. Fortunately, this is no longer the case.

This new and handy compendium of miscellaneous tax materials adequately fills this instructional need. It was compiled under the supervision of Dr. Tunick of the Department of Accountancy of The City College, whose background as a certified public accountant and attorney particularly qualified him for the task. In addition, the subject matter included in the manual was fully tested, before publication, in Dr. Tunick's classes.

The contents of the volume may be briefly summarized, as follows:

1. New York State Taxes:
   - (a) Franchise tax on ordinary business corporations.
   - (b) Franchise tax on real estate corporations.
   - (c) Stock transfer tax.
   - (d) Contributions under the Unemployment Insurance Law.
2. New York City Special Taxes:
   - (a) General business and financial (gross receipts) tax.
   - (b) Retail sales tax.
   - (c) Cigarette tax.
   - (d) Personal property tax.
   - (e) Utilities tax.
   - (f) Conduit companies tax.
   - (g) Occupancy tax.
3. Federal Social Security and Stamp Taxes:
   - (a) Old age and survivors benefit tax.
   - (b) Unemployment insurance tax.
   - (c) Stamp tax.
4. Problem Material:
   One hundred (100) problems classified under the foregoing titles.

In the main, the contents of this Course have been taken bodily from the several tax services regularly published by Prentice-Hall, Inc., after careful selection and editing. This has resulted in the appearance of gaps in the sequence of page numbers, as the publishers have noted in their foreword. I believe that the use of additional subordinate tab cards would have helped considerably, under these circumstances, to facilitate use of the book.

In addition to the service pages, further material, consisting of expanded outlines, points to be stressed, and accounting suggestions, have been interspersed to assist the users of the text. The problem material serves adequately to illustrate the theory sections that precede it.

All current changes in tax law, up to the date of publication, appear to have been reflected in the Course. It should prove entirely satisfactory and will definitely fill the long felt need for such a work.

Emanuel Saxe

MUNICIPAL AND GOVERNMENTAL ACCOUNTING. By Carl H. Chatters and Irving Tenner. Prentice-Hall—New York, 1940. 780 pages, $6.

This well-arranged and inclusive work should be of real assistance to students as well as those actively

engaged in the specialized field of accounting for government and municipality. The authors have based their writings on experience gained in actual contact with and work done for governmental bodies, and include—in addition to the technical—some valuable instruction in the theories of political science and public finance.

It is stated in the preface, "The subject of governmental accounting cannot be regarded solely from the fund viewpoint. In addition, it is necessary to discuss matters applicable to all funds, such as the classification of accounts, budgeting, taxes, cash, debt and reporting." That the authors have followed this program is exemplified by the fact that the book is divided into six subjective parts. An idea of the comprehensive nature of the work can best be shown by indicating herein what each section comprises—

Part I: Nature of Government and Essential Principles of Governmental Accounting

Part II: Funds—(general, special revenue, bond, sinking, utility, etc.)

Part III: Revenues and Expenditures

Part IV: Assets and Liabilities

Part V. Financial Reports

Part VI: Federal Government Accounting

In addition, the volume contains a section on governmental accounting terminology, and a very comprehensive bibliography. The space given over to questions and problems comprises almost a quarter of the work, and the entire text is well illustrated by many reports, forms, and examples.

Bank and Trust Company Auditing

The papers which follow were presented at a round-table forum meeting on the evening of May 3, 1939, at the Hotel Woodstock, New York City under the direction of the Committee on Bank and Trust Company Auditing. The meeting was opened by Mr. Archie F. Reeve, Treasurer of the Society, who in turn introduced Mr. Philip S. Suffern, Chairman of the Committee, who presided.

Loans and Discounts

By Christian Oehler, C.P.A.

IT is not intended that what I shall say be interpreted as a complete audit program of procedure; it is necessarily incomplete because of the time allotted to these various talks, and perhaps that is not a disadvantage in that it will perhaps promote discussion.

I suppose we ought to start making a classification of the items into their fundamental groups of loans and discounts. As a rule the word "loan" applies to collateral loans, and the word "discount" as a rule means "bills purchased." Theoretically, the distinction between a loan and a discount is the question as to whether the interest on the loan has been deducted in advance—the discount—or is payable at periodic intervals following the loan.

The duty of the examiner is to verify that all of the loans that have been made by the bank and that are open at the date of the examination are properly evidenced by notes and other documents in the bank's files—that the collateral that has been pledged as security is actually in the possession of the bank and is properly assigned or supported by a power of attorney and covers the value of the loan, and to determine also the sufficiency of the collateral.

The extent of the examiner's duty, of course, depends upon the terms of his engagement. If he is to present an unqualified report it is necessary that he make a complete verification of all the assets. If he is merely acting as assistant to one of the directors who are making their own examination—if he is making, therefore, an examination of a limited nature—the limitations will be those imposed upon him by the limited nature of his engagement, and his report will be properly qualified.

The time of the examination is an important factor; it is important that we get the work done promptly and the vault released. It is particularly important in a large bank. The larger the bank the more active the securities are, and if we have to trace a great many changes—items in and out of the vault—it becomes an excessively tedious job. In the small bank it is not quite so important. If the activity is light we may carry along for several days or maybe for a week or so without causing annoyance to the client or to the client's employees. The important point that should be watched is that we must attack the job promptly and finish it promptly so that the vault may be released without undue delay.

With regard to collateral loans, the first step in the procedure is a comparison of the notes with the amounts shown on the loan card. A comparison also of the amounts on the loan card with the amounts shown on the tape that is run from the loan card, and then a re-run of

the tape must be effected, because the tapes can be manipulated. You will probably find that employment of a comptometer operator will save you a considerable amount of time and expense in handling the verification of these tapes, that is, the verification of the footings of them.

After we have established the agreement of the notes with the control we will examine the securities that are held as collateral, and they will be compared with the loan card. Following that, the loans will be priced. In pricing the loans it is necessary that we look to outside sources—to published quotations, quotations in the newspapers or in the commercial and financial chronicles.

Now during the process of the examination there are certain matters that will be necessary to list for attention:

Any lack of notes, if notes are missing.—Now it may be perfectly legitimate that they are missing—they may be out for collection—but we need to know that, because they need to be verified. Sometimes it happens that instead of having a note, the customer may have a loan agreement with the bank, and you will have no note to inspect; but it will be necessary to see the loan agreement.

Any lack of endorsement—I do not need to go through these because they are listed in the outline that is given you.

The word "secured" is somewhat unfortunate, but it is in almost universal use. The word "secured" is really an expression of hope rather than a statement of fact. Of course the accountant does not intend it as a statement of fact, he intends it as an expression of opinion, but it is not always interpreted that way.

Past due loans need to be listed with full particulars, and the question there of course is what is to be done with them. In this connection we might raise the question as to just what constitutes a past due loan. Occasionally it happens that a note is current, but it represents a series of renewals. It is somewhat discouraging sometimes to come into a bank for a second examination and for a third examination and find the same notes there. The notes are current in the sense that they have not yet reached maturity; the officers of the bank have kept them up-to-date, have kept them renewed, but there is always some question in my mind as to whether those notes are actually current notes—they may develop into capital loans.

Any unmatured loans about which there may be any cause for suspicion as to their ultimate collectibility will need to be noted, and we will need to pick up information as to any guarantors or endorsers on the notes.

Now absence of the collateral form of note is not serious if a collateral agreement is there, and it is not necessary that the stocks be actually assigned provided a power of attorney is present.

Confirmations are a subject of considerable importance it seems to me, particularly with regard to collateral loans. As far as I can determine it is not standard practice to require a confirmation of loans and discounts, but it is my considered opinion that it should be. Now after the vault is closed at night and sealed, the confirmation requests should be prepared from the loan cards, (this is assuming that you are going to confirm the loans) and when the typing has been completed, tapes should be run of the confirmations and proved with the control. The requests are then numbered so that we can keep control of them, and those numbers can be indicated along the tape so that we can continue to keep control of them, then they are separated and the duplicates may be used as a basis for your collateral count. As a rule it is difficult to get the collateral count

started in the evening, and I think in most cases it is started the following morning anyway, so if this preliminary work can be done the evening before and we have the confirmation request against which we can count, it also serves as a helpful record for our work in pricing and valuing the loans if we are going to do that.

Now as to bills purchased, we need to inspect the notes and compare them with the detailed record and with the tape that is furnished by the bank, and once more re-run the tape and see that it is in agreement with the control. It is helpful to prepare a schedule for use in making excerpts from the credit files. This schedule may be an analysis sheet, but it is probably helpful to have each discount on a separate sheet of paper—we can sort them out and handle them more readily—and those can contain the amounts and we can run tapes of them.

In examining the credit files there are two things we need to watch; first, the ability to pay, and secondly, the willingness to pay. Now there are some people who think that the willingness to pay is not a matter of interest, but it is. The fact that a borrower is willing to pay is very helpful when we are considering the possibility of any delay in the payment of the note, also his past reputation. If he has the ability to pay we can force him to pay, but that process of forcing may be an expensive situation, so that a loan, other things being equal, where the borrower has an excellent record of payment, is more valuable.

I have spoken about the renewals. We have to watch them because they may be of no particular value, though maybe just carried along there, and we wonder what kind of an asset it is. The notes that were given to you may refer to deposit balances that may be held as collateral; we do not want to overlook them.

Then we need to classify the loans —to pull out any loans payable to officers or directors of the bank, or those who are officers or directors of the borrowing company or of any of the customers of the bank.

The liability ledger is a central ledger where all of the information with regard to the liability of the customer to the bank is brought together in one place. That title "liability ledger" is a little confusing to one not familiar with the language of the bank. It means the liability of the customer to the bank, and of course represents an asset.

In taking off the detail from the liability ledger we may confine ourselves to just the customer's name and amount if the other detail that is mentioned in these outlines is elsewhere in our papers. If that is so, it is important that the papers be cross-referenced.

Investments

By Orrin R. Judd, C.P.A.

I suppose I have been asked to take this subject because the savings bank is not strictly a bank. As I was taught by Colonel Sprague when studying in New York University years ago, a savings bank is an investment machine rather than a bank in the sense that commercial banks are regarded, and the subject that has been assigned to me is perhaps the easiest of the lot, anyway.

Perhaps the easiest thing a bank examiner has to do is to verify the existence of the investments. To begin with, they are under control and they are sealed until counted and accounted for by the examiner.

The first step would be, of course,

to count the investments and make a record of them, then to compare that count with the ledger cards or pages which are entered in total and in detail in the general ledger. It is all a part of the balance sheet for the day in which the audit is made.

If this is a second or third examination, you will have with you, probably, the cards on which you have the results of your last examination, and you can check the changes from the original list to the current list. It is important, in an institution, to see that the changes have been properly authorized by the minutes of the board of trustees or the committee that is authorized to make investments and change investments, then, having counted them and checked them to the card records or the ledger records on which the securities are listed by name and number, etc., to prove that listing by adding machine; then, to inspect the character of those investments for a report—see whether they are in default or whether they are in good standing; to verify by inspection of the records the receipt of interest from the time of the last examination and see whether that is up-to-date; to see that the amortization (if these are kept as a permanent investment in the savings bank) is properly figured and carried in the books, also that, if there is a reserve against the market value of investments which have depreciated below their cost, it is properly credited. That record is very important for the next examination in order that you may be able to prove more quickly what the results of the quarter or the period under examination have been, and to prove more quickly the accruals of interest by the records.

Now this topic says, "Investments—Securities, Bonds and Mortgages, Real Estate, etc." We all know that for many years bonds and mortgages have been one of the favorite investments of the savings banks because of their better rate of interest on the current bonds, but they are more like permanent investments, too, because they are not liquid, so a very careful examination must be made of the mortgages so they can be verified first as to count and second as to quality, and the quality is determined, at least for the time being, by whether they keep up the payment of interest and taxes, and the records in which those details are kept must be carefully examined and proved with the internal audit (if there is one) showing that the auditing department of the bank has verified the receipt of interest and the crediting of interest to the mortgagors who have paid.

The mortgages must be listed and classified according to their value, as may be evident by the standing at the time of their examination.

The third item on this list is "Real Estate." Savings banks, as you know, in recent years particularly have been troubled a great deal with the foreclosure of mortgages and the acquisition of the real estate. Careful records must be kept of that and verified by the auditors to see that the proper amount of the mortgage, the expenses in connection with the real estate and acquisition are properly recorded and have been written off and capitalized in accordance with the action of the board of trustees or the proper authorities in the bank with reference to that particular asset.

Careful record is kept of the expense and the income of the real estate, showing over the period in which it is held all the items that are paid out for upkeep, for rehabilitation and the items of income in the way of rents that may be received, and the real estate then should be classified as to whether it is carrying itself — yielding more income than the outgo—and in banks not permitted to hold real estate for longer than five years a record must

be kept and examined and proved as to the time that real estate has been held and the proper permission to hold it, if it has been held longer than five years; in the classification of that real estate also into items that have been appraised for more than their book value or for less than their book value, the question should be raised as to whether the proper write-off has been made on appraisal of the foreclosed real estate; further as to whether the proceeds of sales of real estate have been properly accounted for, and as to whether the asset as shown on the books is really an asset that could be reported as a proper asset of a sound institution.

I do not know if there is anything more I can say. It says "etc". I do not know what the et cetera would be, but there are various other miscellaneous items, not so much in savings banks. For example, savings banks are permitted to make collateral loans on mortgages for not more than a certain proportion of the amount of the mortgage. That is one class of investment different from either the bond, the mortgage or the real estate.

Then, there are some banks that make loans on pass books; those are held as collateral. They must be properly verified with the amount of the balance on hand and whether this is in agreement as shown by the pass book and whether that is in agreement with the ledgers and is a properly made loan. Some banks do not make pass book loans because it is merely for the purpose of letting the depositor earn a little interest on his accounts and pay interest to the bank rather than lose the quarter's interest, whether or not the amount that he loses in the period or quarter that the deposit has been with bank without interest is sufficient to warrant him in borrowing the money until the end of that quarter. It is a question of mathematics when the interest rate is two per cent and you are paying four, whether it would pay you to do it.

Depositors' Accounts, etc., in Smaller Commercial Banks

By ROBERT C. SCHAEDLE, C. P. A.

This applies to small commercial banks and not to savings banks or the larger commercial institutions.

In these days, with the smaller national banks examined by the FDIC and Federal examiners jointly and by the directors, and the State banks examined by the FDIC, the State Banking Department and by the directors, the small banks feel deluged with examinations. While the law must be obeyed requiring the directors' examination (done by the public accountant), the examination is usually the minimum. Adhering to this minimum usually involves the liabilities, of which the depositors' balances are the major portion.

Checking Accounts—Proof of Ledger

As noted in the program distributed tonight, the proving of the depositors' ledgers with the control accounts is essential. These accounts are usually alphabetical and are divided into several individual controls, based on the number of accounts, of posting machines or clerks. The public accountant making the examination of the small bank may (1) accept the tape of the individual ledger accounts as prepared by the bank's employees, checking the items back to the ledger accounts and footing same, or (2) have his own men run the ledgers.

By using a large group of men for two or three days the assistants whose first task is to count cash are assigned to the various depositors' ledgers. This is usually about the time the bank's employees have completed posting the day's transactions.

Internal audits by the employees usually call for a proof of the ledgers once a week.

Overdrafts, if any, are noted by the assistant and receive the attention of the accountant in charge. However, in many banks, overdrafts are charged to a general ledger control account, where they are more readily reviewed by an officer than if retained in the depositors' control.

Inactive accounts are often segregated and kept in the vault, all transactions thereon coming under the supervision of an officer.

Confirmation of Checking Accounts

The confirmation of depositors' checking account balances is usually not part of the ordinary procedure. In the smaller banks it is very seldom done. If public accountants could convince directors that these accounts should be confirmed at least every two or three years, something worth while would be accomplished.

While it is advisable, in the public accountant's or directors' examination, to do things which the banking department examiners do not ordinarily cover, there are always limitations to the amount of the audit fee and expenses. Where such confirmations are planned, it is usually advisable to make the examination as of the close of a month. The entire procedure to be followed should be determined in advance by the man in charge in order to be as effective and efficient as possible.

All checking accounts should be confirmed, active and inactive, as tellers' and officers' shortages are easily buried or lost in the depositors' accounts. An example is a delayed credit of only one day on a cash deposit to an active account such as the large cash markets of the "Big Ben" or "King Kullen" variety, while the cash is temporarily thrown in the cash drawer for the auditor's count. In the small bank such occurrences can be partly controlled by insisting on or giving vacations, and by shifting tellers. In general, no one used for receiving cash in the small bank, either regularly or as relief tellers, should be permitted to work on the depositors' ledgers or other books of account. These suggestions are, of course, from the viewpoint of internal control.

Other Depositors Controls

Other controls are: Checkmaster, school saving or thrift accounts, Christmas club, trust deposits, dormant checking accounts, tax deposits and time accounts. These ledgers are also taped and proven with the control account.

The largest of these controls is the time or savings accounts. In the smaller banks the total of this control is often considerably larger than the balance of the checking account control, especially in the smaller villages where there are no savings banks or savings and loan associations, although these latter associations are more numerous and are increasing.

With no restrictions to $7,500 on these accounts, individual balances are often very large. I know of one case where a $500,000 account was part of a liability on time accounts of $3,000,000.

The internal audit of these accounts usually calls for a proof of these time ledger controls at least once a month. Differences found on the directors examination may be run down on transactions since the last proof. One case I recently ran across was where a stop had been placed on a time account and the card placed accidentally in the closed

accounts prior to our examination but subsequent to the last proof.

There is a subsidiary control on the cards in each drawer or can, so that differences may be localized. The finding of a difference, if small, may be turned over to the bank's employees.

Time deposit book balances may be tested by examining pass books presented for entries on one or two days during the examination.

Trust deposits in the smaller banks may be grouped in a separate control. Though no audit may be made of that department, a confirmation of the individual cash balances in this control can be obtained from the bank's trust officer.

Individual controls are kept for each year's Christmas club. The remaining unpaid balances of prior years' clubs are sometimes grouped in one control. Several institutions have opened a time or savings account for the remaining balance of each year's club. In that case the Christmas club control consists only of the current year's accounts.

Other Liabilities

Cashiers' checks or bank money orders, certificates of deposit and certified checks are proven by listing the outstanding items. Items cancelled since the previous examination or during the period of the examination can be inspected.

Capital Stock

The examination of these records, of a small bank is similar to that of any commercial institution. The outstanding certificates, per the register, are proven and all charges since the previous examination are followed through from the viewpoints of endorsements and stamps. If there is a registrar a confirmation should be obtained.

The Verification of Cash, Confirmation of Bank Balances, etc.

By George M. Freedman, C.P.A.

Without having arranged an audit program of the cash account I will try to proceed with the work as we would start it in the examination of a bank. I may pass over some of the parts of a real cash account. Not having a definite program I would be willing to answer later all questions in that respect.

One of the first duties on entering a bank is to assign a man to each paying teller's cage. As a rule we generally walk in around three o'clock. The paying tellers at that time are just starting to foot up their proof for the day.

The idea of having a man in the cage with the teller is to avoid the transfer of any funds from one cage to the other. As a rule it takes a paying teller anywhere from fifteen minutes to an hour to prove his cash for his particular cage, and when he has proved up his cash with his control (the control he carries forward each day), you assign the particular man in that cage to count the money.

As a rule, in the count of cash, we ask for not only the presence of the teller but for the presence of an officer of the bank. There is a selfish reason for asking for that favor—money may be missing between the time you count the money and the following morning, and you want to feel safe, after you have counted it and passed it on and put it back in the vault. After the count has been proved it is usually locked up in a teller's vault.

In addition to the cash in the teller's cage, you will find that at the end of each day there are transfers made from the note department

—the collection department—all in cash into at least one of the teller's cash during the day. Of course those transfers are checked out with the proof taken at the end of the day. Now in addition to the cash the teller has in the cage, he has a special fund which he draws on during the day if the demand is great. That cash, generally, is locked up in his own particular vault, and one of the things you first would do would be to seal that particular vault. That is done before you assign the man to the cage. As a part of his proof you would count the money in the cage and the money in his particular vault, and after his count has been proven out you would release his part of the vault. That is done with each teller in the bank.

In addition to that you will find reserve cash—monies that are in large denominations, monies bundled together, coin that is sealed and sent up from the Federal Reserve as a rule, or monies transferred from one bank to another if they have a local clearing house.

Now as part of your cash audit you seal that reserve of cash until you are ready for it. After your paying teller's cash has been counted and proved, the next step is to release the vault in which this reserve cash is available.

The count of reserve cash is usually a very tedious job because you will find, in the reserve cash, bundled cash made up in stacks of ten bundles of $100, or ten bundles of two-dollar bills or five-dollar bills or ten-dollar bills, and as a rule, in making the cash count, to count each bill would be a futile job taking a lot of unnecessary time. You can usually judge whether a bundle has been broken. When they are sent up from the Federal Reserve they are packed tightly and if they have been tampered with you can probably tell. In these bundles of dollar bills where you may find anywhere from $10,000 to $25,000 in single bills, out of each bundle we would take two individual hundred-dollar stacks and count them, and if they prove out we would accept each full thousand-dollar bundle as being correct. Of course, with bills in denominations of $20 or over, you are more or less skeptical and you usually count them regardless of the amount.

After you have proved the cash with your paying teller you run up your summary and prove it to your control. The control is posted from previous days in your present day's proof sheet and, as a rule, it proves out; if it does not it means going back and trying to find where the missing money is.

The importance in counting cash immediately, is not to tie up the workings of the bank. Cash is the one commodity in which they deal every minute of the day, and the first step—and practically the first complete step—in any bank examination is the count of cash and the release of all the cash available.

My next topic is "Verification of Bank Balances". Now each bank usually has a number of depositories in the city of New York. Some have one and some have as many as ten. The reason for that is the service that these various banks offer to the country bank. I know in one particular bank we have about five or six New York depositories. I find, in one local bank, that it calls on New York City for credit reports on some of the borrowers in the local community. I know of another that furnishes a security service.

All of these depository accounts are usually kept in control—a control for each bank account. Regardless of how many depositories you have, you will have that many accounts. Ordinarily you will find one or two active accounts. Usually, at the evening of the examination, you will send out your confirmation letters to these various depositories,

and in your requests for confirmation you will ask for the bank statement that is a continuation of the statement of the prior week. Active accounts are usually settled each week —active bank accounts between depositories—and if the examiner should walk in on, say, Wednesday or Friday of the particular week, he would ask for the current bank statement, picking up the old balances.

We usually allow the bank bookkeeper to make up his bank reconciliation and we check that to the bank book and to the bank statement. The bank statement customarily sent to the depository is received by you and not by the bank and when you are through with the confirmation of these accounts you turn them over to the bank bookkeeper.

I may have overlooked some items in the verification of cash and if so I will answer them later.

Proof of Branch Bank Balances

By Christian Oehler, C. P. A.

There are several differences in types of branch banks, some may be just cash branches that may do a little lending from time to time, others may be complete unit banks, and of course there are corresponding differences in the accounting.

In some cases all of the accounts may be kept at the main office and no accounts kept at the branch at all, in other cases we go to the other extreme and find a complete general ledger and all the subsidiary ledgers kept at the branch. One bank I know has all its depositors' ledgers, rack and transit departments, general ledger, etc., in an office neither the main office nor a branch bank, so there are many differences in the type of accounting and the type of work done at the branch.

The first point is, of course, to get the daily statement at the close of business of the day of examination reflecting the assets and liabilities of the branch that you are examining. If there are no general books at the branch it will be necessary to communicate over the telephone with the examiner in charge at the main office and obtain from him the figures from his daily statement of the assets, etc., that belong to the branch. That statement, if it is received over the 'phone, must be checked back carefully to be sure that no figures have been misheard or anything has happened in that connection.

One of the things that one needs to watch where branches are involved is that one must not permit assets or important documents to move out of the bank or to come in except under seal. If they come in we want to know about them—we want to hold them to one side.

Rack and exchange items, if they have not left when we arrive, should be sealed or accompanied by an examiner to the main office and the examiner at that point should see that the seal is unbroken or that the items are under control. In other words, we want to be sure they have had nothing happen to them from the time they left the branch.

Any notes to be sent to the main office for collection should be listed, preferably in duplicate, so we can keep a copy at the branch and send a copy to the main office, together with the notes, so that the examiner will know they have been counted and are properly the assets of the branch and not of the main office.

In a branch which is a complete unit branch with its own records the

examination proceeds along the same lines as that of the main office. The account at the main office will usually be found to be in balance, if not it must be brought into balance by application of the reconciling items. Some of the reconciling items might be deposits received at the branch or loans collected on main office or other branch accounts.

In a cash branch that does no lending and just acts as a receiving and paying station, so to speak, there is really nothing there to do except count the cash and count the revenue stamps or anything of that sort, and then list any hold-overs or returned items.

One other point that ought to be noted in connection with branch bank examination is care not to release the vault until you have communicated with the examiner at the main office, because it sometimes happens that items are held at one branch for the account of some other branch or for the account of the main office, and that may not be picked up the first night or the following day, so that we want to hold up the release of the vault until we are sure that everything has been cleared.

Coupon Collections

By Charles A. Hoyler, C.P.A.

The coupon collection department usually carries two kinds of coupons, one the cash coupon and the other coupons held for collection by customers at future dates.

One of the first important things is to see that those two kinds of coupons cannot be brought together and substituted one for the other. The cash coupons of course represent coupons the cash of which has been credited to the customer's account, and therefore appear for the time being as an asset upon the balance sheet of the bank. In proving these they are usually filed in envelopes by customers and companies. It is necessary to examine the contents of the envelope and check it with the date on the face of the envelope. The envelopes should then be listed and proved with the control account.

It is quite essential that the coupons should be scrutinized. I say that to apply to where it would be practical to do that. Some institutions might be so large that it would be impractical and you would have to just sort of use a test check on the scrutinization of the coupons, to determine that they are not in default, and if in doubt as to whether they are in default it is well to list them for further investigation later on.

One of the big factors, of course, is to see that the coupons are not post-dated—that they are all current coupons and good credits to the customer's account. Where there is any doubt in the examiner's mind that the coupon is a collectible coupon it might be well to list the depositor's name so that he can trace it to the depositor's account to see that there is a "hold" placed on the depositor's account and he cannot get the money out until the coupon has been collected. Very often the coupons are assembled and sent for collection that night. Many of them, I understand, are now cleared by the New York Clearing House; if so you can put your confirmations in the same as you would with your exchanges and get them back directly. There are some, however, which are still collected by messengers; if so it is good to check the

returns by messenger with that route sheet.

Now in connection with coupons held for future collection, these are not usually included in the scope of an examination by outside accountants. As a matter of fact, I am informed it is very often not done by the bank itself. In the larger institutions it is quite a job. Most of them keep registers in which coupons are recorded as they are received; in other instances they are received by medium of a receipt system and then filed in date order to act as a tickler for their collection. In either event they are controlled by a nominal control and they should be examined and checked to whatever record is maintained in the bank.

The receipt issued to the customer is prepared sometimes in fanfold style by a machine operation, and a copy of this fanfold serves as a credit posting medium to the customer's account.

In most large institutions separate controls are kept on the coupons that are put into this coupon collection department and the auditing department. The auditing department receives a copy of the receipt which is originally issued to the customer making a deposit. Now where you do not keep a check on the coupons that are sent out by means of route collections, it is well to call for all coupons that are returned for four or five days after the examination starts, the same as you would on returned checks.

Now on this stock transfer department and the registrar functions, a bank never acts as both for the same company. It either acts as transfer agent or registrar. When it is acting as transfer agent why you usually can confirm the correctness of the bank's records by receiving confirmation from the registrar bank.

In the transfer department there is a transit book (I do not know whether they call it the same in all institutions) which takes care of all securities which are in transit, being held for some question or other, and the contents of that book should be examined and noted and the disposition of the securities contained therein should be carefully traced.

Unissued certificates.—These certificates are on hand and should be examined and checked with the records (unissued *stock* certificates, that is). The large banks deposit these in a vault on regular in-and-out tickets. They deposit them on the in tickets and withdraw them on the out tickets. When a security is received for transfer, usually a window ticket is issued, a copy of which is pinned right to the security that is delivered, and that ticket accompanies the security through the various operations throughout the department.

I brought up this point of registrar before. If no registrar is acting, then the bank should be able to produce either the old certificates or cremation certificates evidencing the destruction of the old certificates which were transferred. By the way, I might add there that in each case the bank acting as transfer agent would maintain a stock ledger in addition to the unissued certificates, and if it is not acting as registrar would also have the old certificates available. A proof can be taken and also a transfer checked with the journal.

Now we have the question of registered bonds, which are somewhat similarly handled as the stocks excepting that in the transfer of a bond a new certificate is not issued. The same bond carries right on through the procedure and is transferred from one holder to another.

The books used for bond registration usually are the transfer books, an index which is an index to all bondholders to whom interest is to

be paid on registered bonds, and the holders' ledger. In the payment of registered interest the bank sometimes acts as a paying agent, in which case it receives funds from the company and these funds are held in special trust accounts and the checks drawn against the account can be examined and the balance reconciled with the outstanding checks as final.

The question of dividend payments is approximately the same. The bank there receives the money with which to pay the dividends and keeps it in a separate account, disbursing it from that fund.

With incoming coupons a numbered receipt is issued and it is stamped on the envelope so that these coupons follow right on through and are cancelled when the payment is made, the coupons filed and eventually destroyed if they are not returned to either the registrar or the company, in which event they would be supported by cremation certificate receipts if they are destroyed by the bank.

The Special Examination of Savings Banks

By Lloyd A. Barnstead, C.P.A.

The public accountant may receive instructions from the president of the bank or examining committee of the board of trustees to examine and report on the assets presented in a statement of condition of the savings bank, and in this discussion a bank with assets of around 150 millions is contemplated. The accountant should make himself familiar with the internal routine, the existing accounting records and the physical location of the assets to be counted, in order to make a controlled and intelligent examination as of the date of the statement.

Savings banks keep a general ledger for the purpose of arriving at daily condition statements. The balances in this record will provide the control proof over the various assets and the subsidiary bank records therefor examined by the accountant.

The actual examination will probably commence on the morning of the closing day which will find the supervising accountant and his staff in the bank vault with one or more officers of the bank, ready to proceed on the count of cash, securities and bonds and mortgages.

The accountant should have on hand a list of the location of the cash funds, as required by the cash routine of the bank. There will probably be in the vault the reserve supply, the tellers' supply for the next day's business, the vault supply, and packaged currency as received with Federal Reserve Bank strapping. Count thereof should proceed, a record being made, and control exercised to prevent duplication. Control is continued until the balance of cash in the hands of the tellers on duty is later counted after the close of business, at which time all cash after being proved with the closing balance shown in the daily cash book will be in the vault and the vault closed, whereupon control of the cash will be released. There will probably be a section of the vault for cash separate from a section for other assets.

Funds on deposit at various banks and trust companies will be reconciled with the savings bank records and confirmed with the depositories later in the course of the examination. Funds collected under assignments of rents or other agreements available for the payment of

taxes, interest, etc. on mortgage investments in default, should be separately deposited and in agreement with the contra liability therefor shown on the bank books.

After count of the reserve cash in the morning, the securities count may start. The bank should have ready for the accountant a list of all security investments showing par value, description, amortized cost, "Superintendent's Value," and interest detail. If the securities are kept in numbered books, grouped by like kind of government or corporate issues, the supervisor of the count should require production of all books in the vault before proceeding on the count. The books of securities received will be checked off to a list thereof by number. The securities counted will be checked to the list furnished by the bank. Upon completion of the count of a book the number will be noted on the book list and the book released back to the vault by a bank employee, still under the control of the supervising accountant. Upon completion of the full securities count and the return of all books to the vault, the supervisor should check his tally sheet thereof against their final resting place with an officer of the bank. Control of the vault will be maintained until it is closed. The total cost of securities counted on the bank list will check at the close of business with the daily ledger balance. Any investment in the Savings Bank Trust Company and Institutional Securities Corporation should be evidenced by shares of stock and debentures on hand. Any deposit of securities or bonds and mortgages with the Savings Bank Trust Company should be confirmed and the terms of the deposit agreement noted.

Subsequent to the counting day the security list will be checked in detail to the bank's security ledger. It is well for the accountant to recommend a check of the calculated amortization cost if it has not been done before. The Superintendent of Banks issues a book entitled "Estimated Market Value to be used by Savings Banks in Preparation of Statement of Condition as of (given date)" which the accountant will use in checking the calculation of the "Superintendent's Value" shown on the security list. The legality of investments made under the requirements set forth in Article VI of the New York Banking Law is not within the province of the accountant's examination. The accountant should know the kind of eligible investments, but not their financial status except for reporting past due interest or maturities. Any investments not found on the current "List of Securities Considered Legal Investments for Savings Banks" as issued by the Superintendent of Banks, nor priced in the above book referring to estimated market values, should be traced to the board of trustees' resolution authorizing its acquisition.

Either on the day before or the day after or while the foregoing count of cash and securities is proceeding, a separate group of accountants should examine the bond and mortgage documents, as to which the bank should have ready a list showing the mortgage number, unpaid principal amount, and interest detail. The documents will probably be found in numerical order and should be produced to the accountant all at one time. The accountant should satisfy himself that there is a bond, a mortgage or assignment of mortgage, running to the savings bank, equal to or in excess of the unpaid principal amount shown on the bank list. Missing documents should be accounted for. The accountant assumes no responsibility for the legality of or title to the investment beyond the inspection of the documents produced to him, and

ordinarily does not confirm with the mortgagors. The total principal amount thereof on the bank list will check at the close of business with the daily ledger balance.

The completion of the bond and mortgage count and return of the documents to the vault in a large bank will generally take longer than the cash and securities count and the accountant should not relinquish control of the documents until the count is completed.

Subsequent to the counting day, the bond and mortgage list will be checked in detail to the bank's mortgage records as to unpaid principal and interest detail.

In the verification of interest accrued to the date of the condition statement, it will ordinarily be found that interest is not recorded on the security or mortgage records until due, and that interest on such investments past due more than six months is carried in suspense accrual and not taken into earnings until collected. The bank will maintain suspense records thereof, and in the course of verifying the computation of the accrued amount of such interest the accountant should report the principal sum of such investments, but does not ordinarily confirm these items with the mortgagors. As a result of this procedure the accrued interest taken into earnings will be current. The periodic bills for interest due rendered to the mortgagors by the bank is an item of the internal control to be considered by the accountant.

Taxes, insurance, etc., advanced for mortgagors shown as an asset should be evidenced by properly approved vouchers, together with receipted tax bills and/or invoices, and usually arise in connection with mortgages in suspense on which the collection of interest is considered doubtful.

Real estate owned, other than the bank premises, will probably be found to have been received in mortgage foreclosures. The accountant should list same and check the carrying value to the trustees' resolution setting the appraisal value thereof, and such carrying values will not be in excess of the principal amount of the foreclosed mortgage plus cost of subsequent improvements or appraisal value if less. The bank will probably have a real estate department supervising the operation of such properties, ordinarily placed in the hands of real estate brokers for management, and the revenue and expenses will probably be on a cash basis. Title deeds to property are not examined by the accountant.

The provisions relating to the membership of a savings bank in the "Fund for Insuring Deposits in Savings Banks and/or Otherwise Protecting Depositors" are set forth in Article VI-A of the New York Banking Law. The contribution to this mutual savings bank fund by the bank being examined should be evidenced by certificates of payment, and any reduction in the carrying value thereof should be authorized by the board of trustees and the provisions of any order of the Banking Department thereon noted.

Generally

Smaller savings banks, which may not have the complete internal check and routine found in a large bank, may require a different examination procedure by the public accountant.

An examination of the assets in a statement of condition does not involve an audit of balances in depositors' accounts. However, if the accountant's instructions cover such item the unit teller system of machine bookkeeping, with locked machine controls, internal audit and daily balancing thereof, will provide the best control. Dormant accounts should be inspected at least annually by an officer of the bank and the reason for any activity ascertained.

The accountant may occasionally receive instructions to check the pass books presented to tellers for deposits and withdrawals in the ordinary course of business.

Reference is made to Article X-A of the New York Banking Law in effect January 1, 1939, providing for the establishment of savings bank life insurance departments not discussed here. Section 314 thereof provides that the assets and liabilities and matters of accounting and investment of a savings department be kept distinct from those of an insurance department.

Trust Examinations

By Duncan Merriwether, C.P.A.

I am on the receiving end of examinations, and my remarks may be colored to some extent.

Mr. Hoyler has covered some of the departments which would be in a corporate trust department—some of the sections; I shall not include in my remarks reference to corporate trust functions. If there are questions, someone in the room will be able to answer them even if I cannot.

The function of trust departments (that is, the personal trust departments including the administration of estates and trusts) is to hold and administer the property of others under a wide variety of governing instruments. The nature of the audit derives from the nature of the trust business—that is, the holding of other people's property and the administering of it under a variety of instruments.

The examiner must satisfy himself that the assets received are either on hand or have been delivered out in such a way that there will be no liability to the corporate trustee or executor. He must satisfy himself that income in connection with those assets is on hand or, again, has been delivered out to the people for whom it was intended. And a third function of the examiner is to satisfy himself that no unrecorded liability exists for past maladministration and that current administration and investment procedure is such as to protect the fiduciary.

The third section is one on which there can be much argument. There is room for lots of difference of opinion as to where the examiner's responsibility begins and ends.

The first two sections we can handle easily. From the trust department trial balance, and memorandum control accounts, (and sometimes very important accounts in the trust department are not on its trial balance but are maintained by memorandum control accounts) can be established control over the fiduciary assets and the income. Of course it is necessary to satisfy one's self that the trial balance itself is so derived that all of the items which should be covered by such a trial balance are included; that is, that it includes all the transactions.

The major task from the time standpoint in examining a personal trust department is in the verification of the trust assets. They are checked to the asset records of the individual accounts or to lists prepared from those individual accounts of securities in the vault.

All the assets under control should be accounted for. They should be in the name of the trust account itself and not in the name of the bank or trust company. That is a point on which the verification of trust assets of course differs from a verification of the bank's own investments. It is frequently found that such assets are in the name of nominees.

The nominee is receiving a lot of attention these days. There is a decision under Surrogate Delehanty that a trustee in a surrogate trust should not maintain securities in the name of a nominee. Regardless of the merit of that decision, it indicates the jealousy with which the courts are attempting to protect the beneficiary from a mixing of the assets of the trust company itself and the trust account.

Then there are, in a trust business, a lot of miscellaneous assets: Jewelry—a very wide variety of debris is collected by most people in their lifetime which may find its way into a trust department. That should be under control (it usually is) and it is necessary to go through with it in the verification just as it is to examine the worthless securities of which every bank has a large batch, particularly in estates.

As to the checking of income, a complete check, I suppose, in any institution of any size, is impracticable. Certainly it would be an expensive task. The system of internal check and control is usually depended upon to a large extent. Where a beneficiary spends all the income from a trust each year, the beneficiary is apt to complain if he does not get all of his income promptly, and that acts as an independent check on the trustee.

On estate accounts and accounts where the income is accumulated, tests should certainly be made of the income to see that the account receives all of it. You will usually find that someone in the division is checking that in addition to the people handling it. For instance, in the calculating of commissions, the one calculating them is usually independent of anybody else and he will see that a check is properly made. That usually occurs within the institution so that the checking of income from observation (and I have to speak largely from observation) is something done largely in the bank itself by the bank's own system of internal control.

Examination of trust departments until recent years was confined almost exclusively to the verification of the assets in the accounts. Now that is a part I have mentioned and I have no doubt anybody in the room could handle that part of an examination, perhaps as well as I could, certainly. There are some features of it which are different from a bank. There will be a lot of exceptions in the examination of securities, mortgages will be found with no appraisals and perhaps no other documents, perhaps because someone died and left it that way and a complete set of documents has not been made up due to lack of time. There will be numerous such exceptions in a trust business which would not be found in a bank's own books.

The third section is a search for unrecorded liabilities and the isolation of practices which may lead to direct liability of the trust company requires a different type of attack. This section of the examination seems to be considered of primary importance by the highly competent examiners for the Federal Reserve System, and I might say that although we do not ordinarily think of government employees being the type of people who do original work or expand the scope of this work, one has to admit that the best work done in recent years has been done with the Federal Reserve Bank of New York—possibly in Philadelphia and possibly some others with which I am not acquainted. Increasing interest is being shown in procedures and practices which reflect the integrity of the management, and the competence of the corporate trustee.

This may be a section where, having been on the receiving end of trust examinations, I can list some of the things which examiners (of which we have four sets each year)

are bringing up in recent years which were not commonly brought up prior to, say, 1930.

Regularity and frequency of judicial settlements of accounts, as disclosed by an aging schedule.—Perhaps the only release a trustee has from his liability is a judicial settlement of accounts. In the absence of fraud that is usually a final release of the open contingent liability of one who has not settled his accounts.

The length of time required to settle estates.—Scrutiny of those not settled within two years to understand or find out why it has not been done. Of course we know there are many tax cases which hold estates open indefinitely; sometimes there are parcels of real estate which cannot be sold for a long period. There are lots of reasons why they should drag on longer than two years, but when they do the matter should require somebody's attention besides the man administering the estates.

Adequacy and retention period relating to trust department records. It makes it very difficult to intelligently account, twenty or thirty years later, for the action someone else has committed, unless the records have been carefully preserved.

Holdings of the bank's own stock in trust accounts. That perhaps is wise only where the bank is requested to do so by someone who has control of the investments outside the institution; it is not good practice, certainly, for a fiduciary to invest in his own business.

Holdings of the securities of companies in which directors, officers and employees have an interest. The connection does not require any explanation, I think.

Obligations of directors, officers and employees to trust accounts. There can be such things, especially through involuntary trusts.

Adequacy of the investment reviews, and the frequency with which they are made, and following along with that the Federal Reserve Bank has issued regulations which define, to a large extent, the way that a trust department should be set up and the way responsibilities should be centered on the senior officer who cannot avoid taking responsibility for the mistakes which may be made in the trust business.

Reviewing of selected accounts by making comparative summary of assets at cost and at market value for a period of years, and a comparison of rate of return on these values over a period. That is something which perhaps would rarely have been done (that is, until very recently), and yet it gives the auditor a measure of the effectiveness with which the trust division has operated and perhaps there is not any other measure to determine whether the trust division is making any money for its customers. Usually the intention is to maintain the principal, but a measure of that is the value of the assets left after a period of administration, and the rate of return which has been earned for the income beneficiaries. Investigations of accounts which show a wide deviation from averages will throw into relief the practices which perhaps will stand correction.

The review of litigation with the company's attorneys and a review of settlements made during last audit period may lead into a knowledge of the trust business and the way it is run which one would not get ordinarily and certain other possibilities of further liability in accounts where litigations have not been started or where settlement is not necessary.

A review of purchases of assets by the company from its own fiduciary accounts. If a company is purchasing items from its fiduciary accounts there may be excellent reasons other than where it is faced with a surcharge. It may be that the clerical expense in handling assets is so large

that the company is willing to take them over and handle them on a less expensive basis. That would apply only to a very limited group of assets, but it can happen. In New York State that would apply to mortgages split up into small amounts. The cost of many bookkeeping accounts easily exceeds the annual interest on the $100 or $150 certificates.

That concludes my remarks with one exception—that I must draw attention to a book published this year by the A. B. A., entitled "Trust Examinations (An Examiner's Analysis)," by E. P. Neilan. There is a chapter on "Bank Auditing." This is quite new and outlines a number of things we did not consider in a trust examination until quite recently, and anyone attempting a trust examination in the future will find it very useful.

Discussion on Bank and Trust Company Auditing

The following questions were asked from the floor and were answered by members of the Committee or by other members of the Society:

Treasurer Reeve: I would like to ask Mr. Merriwether as to whether his bank has adopted a plan of endeavoring to have trust accounts accounted for judicially in five or some other number of years? I have had a lot of that work and I find it is very difficult to wind up the records where they go back twenty or thirty years.

Mr. Merriwether: I would rather not be asked questions about my bank, if you do not mind, but we have adopted a policy of accounting at five-year intervals unless there is a reason for not doing so.

For instance, a trust asset may be a note set up to cover a divorce situation. The only asset may be a note, and interest is coming in once a year on it and there is no particular reason to account every five years. Many people sometimes feel there should be an accounting before the surrogate forgets what a tremendous loss has been suffered in depressions through no fault of the trustee. As you may know, in many States the corporate trustee must account at regular intervals; that is the trend.

In our own institution we, no more than anyone else, want to incur any criticism for incurring needless expense, and we have to go very cautiously. It is our hope that eventually we will be on a five-year cycle.

Treasurer Reeve: Thank you. By the way, I understand a bill went through at Albany Monday whereby the trust companies can keep the holdings of their trust securities in the name of their nominee.

A Member: I understand that there has been a change in the regulation with respect to the amortization of bonds purchased above par. The amortization date is not to the maturity date but to the calendar date of the bond. Is that correct?

Chairman Suffern: Yes; that is correct.

Mr. James C. O'Brien: I should like to ask the Committee or any member thereof what the practice is in making an examination for the directors with regard to the accountant's report? You have the question of time and expense, and I understand that in many cases the statutory report which is sent to Albany is sufficient for the directors, and on the other hand that leaves the accountant in the position of not

having given a report outlining the scope of his examination.

Chairman Suffern: I know no reason, Mr. O'Brien, why the accountant making his examination should not submit a report to the trustees which becomes a part of the bank record. He therefore does go on record as to the extent of the examination he has made, which is justification for the fee he charges.

Now it is not required that the report accompany the trustees' or directors' examination that goes to Albany, but they must, in turn, sign this statement on the last page, which is their own report based on the examination the accountants have made in their own behalf, plus their own investigation.

A Member: Mr. Chairman, I would like to ask Mr. Barnstead what he would consider an adequate examination of real estate—that is, for the proper owner of real estate?

Perhaps Mr. Judd can talk about that also, being in a savings bank.

Mr. Barnstead: Well, I would not go into any title deeds on real estate. You will get your index to foreclosures through the index to mortgages. When the mortgage enters into suspense you start to have your assignments of rents, then the bank commences paying taxes and insurance on the property, and through all those different steps where the bank has control, not ownership, you get evidence of ownership through tax bills and insurance bills, etc.

When the property is foreclosed for the mortgage, the board of trustees fixes an appraised value under the Banking Law and it has to be revised within six months of the date of any addition. The appraised value or the principal amount of the mortgage foreclosed plus the cost of any subsequent improvements, whichever is less, is the recorded value. When you go into the bank you will have your real estate records. You should list every piece of real estate according to the bank records and see if an appraisal has been made approved by resolution adopted by the board of trustees, but you do not go on to examine the title deeds to property. It should have been previously handled with the legal counsel and the board.

Chairman Suffern: I would like to see whether anyone differs with that opinion.

A Member: Is it proper to check them out of the city clerk's office?

Mr. Barnstead: I think the attorney should do it.

Chairman Suffern: Mr. Judd, what is your opinion with regard to that?

Mr. Judd: I think the fact that you have the real estate is pretty good evidence you have title to it. You acquire that through a foreclosure of a mortgage in connection with which you acquired a proper guarantee of title and a certificate of an attorney.

Mr. Barnstead: Another point of course is that after you acquire real estate you have the Real Estate Department checking into it. You have income and expense on the property which you would not have if you were not the owner.

Mr. Kermsey: My name is Kermsey and I am a State bank examiner. I would just like to make a remark about Mr. Schaedle's statement about audits and examinations.

Public accountants of course are duty-bound to make an audit, more or less, whereas, as bank examiners, we do not make real audits but merely an examination to see that the bank is solvent and that the bank is living up to the law, but we do not try to detect fraud or irregularity until it more or less turns up, and I think there is an essential difference between an accountant's audit and a bank examination.

Chairman Suffern: Yes, but the subject tonight was "Bank Examinations" and I think you will find, from the group here, that they are obliged to make examinations without audit. If there has been any defalcation that's all there is to it. They do not go back and make an audit of the profit and loss from the last to this examination, but they are called upon to make an examination of the condition of a bank as of a given date.

Now with the exception of an analysis of profit and loss, what has taken place, has; what has been lost is lost. They do not audit all the interim transactions unless they are specifically required to.

Do you agree with that, Mr. McFarland?

Mr. McFarland: Yes, that is right.

A Member: Has the Committee made any definite decision upon the new banking law amended, eliminating one of the examinations per year?

Chairman Suffern: We believe the law stands.

Same Member: But do you believe the bank should have only one examination a year or continue to have two? What should the auditor do in order to cover the entire year if there is only one examination?

Chairman Suffern: Well, do the banks only have one examination in a year?

Same Member: I am talking about the board of directors' examination.

Chairman Suffern: But you see they have these other examinations also, so it is certainly desirable that they engage us as many times as possible, but they do have a pretty constant run of examinations and because of the adequacy of the State and Federal Reserve examinations they now feel it is not necessary to burden the bank with semi-annual directors' examinations, and I do not know that we can do anything about it unless we can point out faults in the examinations as conducted by the Federal Reserve Bank or the State Banking Department. We have heard them commended tonight. I do not think we can do anything about that.

A Member: How is a common trust examined?

Mr. Merriwether: I do not think I can answer that question. So far as I know there is no law in New York State at the present time. There may be one or two in experimental stages but I do not know any which have yet reached the stage where they require an examination. It will undoubtedly have to be worked out when it appears.

Chairman Suffern: Are there other comments?

Mr. William Kennethe Donald: Is it not the practice in any case to confirm mortgages by examinations?

Chairman Suffern: Well, we would have to find that out by perhaps more or less of a questionnaire, but we can ask those accountants who have been making examinations where they have confirmed mortgages to speak very briefly on the subject.

A Member: Mr. Suffern, I know where commercial mortgages are had they are confirmed as investments. That would mean if only 75 or 80 mortgages were held by the client we would confirm them, but in a savings bank we realize there are 2,000 or 3,000 of them. The trustees are averse to doing it and some accountants feel it should be done, so there is a real good argument to get them to permit that.

Chairman Suffern: I do not think that has been the custom.

Same Member: But you know how they are tightening up on examinations these days.

Chairman Suffern: Of course one of the greatest confirmations, as Mr. Barnstead said, is that if you are getting currently your mortgage interest there seems to be some evidence that someone is paying the debt. Whether that debt is a good mortgage debt or some other form of debt is not proved merely by the collection of interest.

Then, just as soon as any mortgage gets in default, which is perhaps the point you would get most suspicious of it, you do have instantly the real estate department of a bank taking over the operation of that property until it comes through.

You see there are certain forms of debts to a bank in which the maker is very important; he is very much less important on a good mortgage than one some of the others, because the property may change hands, but your mortgage still stands until the debt is cleared.

I think it would be a good thing to have it done in larger banks.

Same Member: But, Mr. Suffern, it is a lengthy job to verify it under the collection of interest.

Chairman Suffern: No. As a matter of fact all your interest that comes in is apportioned to the various mortgages, and your mortgage registers show instantly those that are in default, and in your crediting income there the auditing department of a bank is proved daily with the time amount that gets into the bank's earning statement, so there is no doubt as to which mortgages have been paying their interest.

Mr. Charles L. Hughes: I notice it says in these set-ups, "Independent Depositors' Accounts.—List or check types of individual balances."

I would like to ask if that is ever done by tests of blocking off groups of depositors' accounts and satisfying oneself by tests?

Mr. Schaedle: We never test.

Chairman Suffern: And Mr. Oehler, do you have a test?

Mr. Oehler: Yes, we have found it has been requested in some instances. I have particularly in mind one instance in a savings bank that runs a pretty elaborate internal audit department that makes a periodic test and run of its ledger account. In those instances they have limited us and told us to go in and see that the controls were in order and the summary properly taken; but where we are not limited we never make a test.

A Member: Mr. Hoyler, in making your test you would at least complete your control?

Mr. Hoyler: We have got to tie in with something that is definite. That is right.

Chairman Suffern: You would certainly have to limit your report on an examination that took in only a partial test of the liability side.

Mr. Oehler: Of course there is another thing I would like to bring out. We always limit our test when we say we have tested the accounts as recorded on the records and have not confirmed them with the depositors. That, of course, is a job not generally undertaken by very many accountants.

Mr. Judd: But you do make a test of books that come into it during the course of the audit; you compare a book with the ledger?

Mr. Oehler: We do another thing; we select drafts for certain days during the period and run those drafts—prove them up with the ledger and check the signature cards.

A Member: What is the thought in connection with commercial deposit accounts on checking back the tapes?

Mr. Oehler: We have taken the bookkeeper's proofs in some instances, run from the ledgers themselves, and checked them back with the statement department; two separate units posted at different times.

We have in one instance confirmed the deposit accounts, but it was quite a burdensome job. We were successful in getting approximately seventy-eight per cent of the confirmations back, but it took about five letters to get that much.

Chairman Suffern: Of course if irregularities develop the bank will usually employ you to send out your confirmations of the individual commercial deposits, but that is treated as a separate examination.

Mr. Charles J. J. Cox: Does Mr. Barnstead consider it necessary to leave the bonds and mortgages and the abstracts of insurance policies, or is it necessary to obtain from the face of those instruments proof to indicate they are legitimate documents and bear evidence of passing through what we might say regular channels?—If the document indicates it has been drawn by a lawyer and possibly the county clerk's recording—the date, page and further indexing?

Mr. Barnstead: Just take it from the face of the documents; you do not go beyond the documents presented to you which purport to represent the lien on the property.

The bond of course will usually run double the amount of the mortgage and may be the original bond given by some bondsman years ago. The mortgage may run direct to a savings bank or there may be an assignment of it there.

Mr. Cox: There are a few cases of which I know where the bond was signed by one (we'll say) X & Y Guaranty Company, and possibly sealed by the X & Y Title & Mortgage Guaranty Company. Some are inclined to take exception to that and say that it is the accountant's responsibility to disclose that thing.

Another interesting fact I have run into recently—an attorney friend of mine showed me a bond (or a mortgage, I can not recall which) which had been duly recorded but never had been assigned.

Mr. Barnstead: You must remember that all those documents have come into the banks through the banks' attorneys at the time the loan was approved by the board of trustees, so you have a legal check on the documents in the vault and under the control of bank officers. Presumably they have kept control from the time the board of trustees authorized the investment.

Mr. Cox: That has been my opinion and I have been trying to get someone to bear me out.

Restaurant Accounting

At the first of a series of five weekly round-table meetings on the evening of October 18, 1939, at the Engineering Auditorium, 29 West 39th Street, New York City, the following address was delivered under the direction of the Committee on Restaurant Accounting of which Mr. Joseph Brodner is Chairman.

Cafeteria Accounting and Control

By WILLIAM K. BOROW, C.P.A.

MY paper on Cafeteria Accounting and Control was supposed to follow another paper on an allied subject. It seems that this other paper will not be read tonight; so, during my discussion, I will attempt to discuss also the small cafeteria and small restaurant as well as the larger types of operations.

Cafeteria accounting and control differs from hotel restaurant and service restaurant accounting in the methods of cash control and food cost analysis. The cafeteria owner or manager is chiefly interested in accounting for all cash received and the gross profit on his sales. The accounting period in many cafeterias is the calendar week, especially if the cafeteria is closed on Sundays; however, most cafeterias still use the monthly accounting period.

The usual books of account found in a cafeteria are: cash receipts and disbursements book, purchase book, accounts payable ledger, general ledger, payroll register, and cash paid out book. In addition to the above books, several memorandum record books are kept, such as cashier's daily analysis record, cigar and cigarette inventory control records, insurance book and notes payable book. Very few cafeterias maintain beverage control records because, in most instances, beer and soda are the only beverages sold and these can be accounted for through the purchase book.

The usual general ledger accounts are:

Assets:

Cash in Bank
Cash in Register
Food Inventory
Cigar & Cigarette Inventory
Fixtures & Equipment—Reserve for Depreciation of Fixtures & Equipment.
Leasehold (in case cafeteria is purchased and leasehold is part of cost)—Reserve for Amortization of Leasehold.
Prepaid Insurance
Loans & Exchanges
Deposits as Security

Liabilities:

Accounts Payable
Notes Payable—Mortgages
Notes Payable—Others
Sales Taxes Payable
Social Security Taxes Payable
Loans Payable

Capital Accounts:

Capital Stock Issued or Capital Account
Surplus & Undivided Profits Account

Income Accounts:

Food Sales
Cigars & Cigarettes Sales
Other Income (Telephone, Rentals, etc.)

Cost Accounts:

Food Purchases (may be analyzed as meat, poultry, fruit and vegetables, milk, etc.)
Cigars & Cigarettes
Purchase Discount and Allowances

Operating Expense Accounts: (controllable)

Payroll
Payroll Taxes
Supplies (including dishes, utensils for replacement, paper napkins)
Cleaning Supplies & Rubbish Removal (cleaning expenses)
Electric
Gas
Water
Telephone
Insurance (compensation)
Advertising

General Overhead: (non-controllable)

Rent
Taxes & Permits (except payroll and income tax)
Insurance (except compensation)
Legal and Accounting
Depreciation of Fixtures & Equipment
Amortization of Leasehold
Repairs and Maintenance
Interest and Bank Charges
Overages and Shortages

Officers' Salaries Accounts or Partners' Accounts:

(These accounts are not classified with either operating expense or general overhead, but are treated as a separate deduction in the profit and loss statement.)

Inasmuch as one of my colleagues will discuss the profit and loss statement, I will devote most of my remarks to a discussion of cash control and the function of the cash paid out book, and lightly touch upon the various other books of account.

All cafeterias use checks on which are punched progressively the amount of food consumed or purchased. A customer, upon entering the cafeteria, will obtain a check from a check machine which is near the entrance door. These checks are numbered consecutively and are also counted by the machine. In a number of cafeterias the color of the check is changed daily or the check may bear a designating letter of the day or number of the day of the month. Upon leaving the cafeteria the customer pays to the cashier the amount punched on the check. The cashier may ring up each check on the register or, if no register is used, give change with a change machine. At the end of the day or change of shift, these checks are sorted as to amounts, counted, extended and entered into the cashier's daily analysis record. This operation may be done by the cashier or one of the proprietors or managers. The total number of checks must agree with the number of checks issued by the machine. The cashier is responsible for any checks unaccounted for. Simultaneously with the sorting of the checks, one of the proprietors or managers counts the cash in the register. An inventory of cigars and cigarettes is taken and the cash value of such sales is calculated. The total of the checks and cigar and cigarette sales must agree with the amount of cash in the register less the amount of paid outs.

In cafeterias with more than one shift in the cashier's department, each cashier will be required to account for the cash received on his shift and a cash count made before the second cashier takes over. A report is made for each shift, and the cash book will show receipts and paid outs by cashiers.

It is a somewhat common practice in cafeterias to pay various purchase items in cash. A paid out voucher is used for such payments and they are recorded in a cash paid out book. This book is similar to the ordinary **petty cash book** with columns for

the various expenditures made, such as food, supplies, payroll, cleaning expenses, etc.

The cash receipts book will show the daily receipts from food sales, cigarettes and cigars sales, and will also provide a column for paid outs. The total in the paid out column must agree with the total in the cash paid out book. Postings to the general ledger are made directly from the cash paid out book. In the small restaurant we do not find the full use of a paid out book; we simply incorporate the information in the cash book. It is found also, that in the cash book there are columns for food purchases, cleaning expenses, and other expense items.

In making his periodic audit, the accountant should make a test check of the daily receipts if the cash is not proved by the proprietor personally, so as to prevent collusion between the cashier and manager. All paid outs should be countersigned by someone in authority and cancelled by the auditor after checking.

Cash Disbursements Book

Disbursements are usually entered on the right side of the cash book. The customary columns are: Accounts Payable, General Ledger, Labor, Expenses, Social Security, Purchase Discount, and Net Cash. In the expense column are entered minor expense items not recorded in the purchase book.

Purchase Book

As previously mentioned, the small restaurants will not have a purchase book, but the information is usually kept in the cash book, and the disbursements are recorded in the various columns provided. Furthermore, there is no accounts payable ledger, but instead there are two files, namely, an unpaid file and a paid file. At the end of each month, in order to obtain a statement of affairs, you would add up your unpaid bills and make any necessary adjustments on your trial balance.

In the purchase book are entered all purchase bills, including expense bills, such as supplies, rent, electric, gas, telephone, insurance, etc. In most cafeterias only one column is used for food; however, this item may be analyzed into various groupings such as meat, fish, milk, coffee, fruits and vegetables, bread, cake, etc., for monthly or weekly comparative purposes. Most vendors render weekly bills for commodities delivered during the week. Purchase invoices must show signature of person receiving merchandise if a receiving book is not used.

The accountant who is familiar with current price quotations can be of great service to his client by advising him when he is paying more than the market for such items as meat, fish, butter, eggs, milk, etc.

Payroll Records

Every employee is required to register the time of arrival and departure on a sheet provided for this purpose at the cashier's desk. At the end of each day the cashier or bookkeeper transfers this information to the payroll register. The usual payroll register will show the name of employee, social security number, day of the week, with provision for the time worked, total time, rate, amount earned, meals (usually two meals a day at twenty-five cents each), total column, social security deduction, net amount, deductions (usually meals and advances), amount paid. The cash book entry will show the total payroll exclusive of meals, social security deducted, and the amount of cash paid out.

Other items which require special treatment in cafeteria accounting are: compensation insurance, depreciation of fixtures and equipment, and amortization of leasehold. Compensation insurance should be cal-

culated at the rate provided for in the insurance policy and the amount of payroll for the period involved, including the value of meals. In this case you will find that, for compensation purposes, you will have to calculate your meals at the rate of 33⅓c each, which is the approved rate. Depreciation of fixtures and equipment, and amortization of leasehold, are usually prorated over the term of lease.

I have not attempted to quote operating percentages because I am sure that my colleagues will touch upon those items in their discussion of the profit and loss statement.

Restaurant Accounting

The forum meeting of the Committee on Restaurant Accounting, of which Mr. Joseph Brodner is Chairman, was continued on November 27, 1939, at the Engineering Auditorium, 29 West 39th Street, New York City, and the following addresses and discussions were held.

Control of Beverage Sales in Restaurants

By JOSEPH BRODNER, C.P.A.

JUST one month prior to repeal of the Eighteenth Amendment, one of the members of our firm addressed the Hotel Accountants Association of New York City on "Accounting Control of Wines and Liquors". Because of the interest displayed in this subject his talk was printed in booklet form, together with a set of accounting control forms which were thought would adequately serve the purpose. It happens that these forms and the general system outlined have stood the test of time—six years, to be exact.

The theory of beverage accounting and control is basically a combination of inventory and retail sales price control. Furthermore, all the accounting fundamentals of purchasing, receiving and issuing are equally as applicable to the wine and liquor division of the restaurant business as they are to any general merchandising business. Packaged units of merchandise are ordered, received, stocked and issued on requisitions, in the recording of which there are utilized the accounting forms shown in the sheet with which you have been provided.

Were there no differences in the control methods of wine and liquor sales as compared with ordinary unit merchandise sales, we could simply refer to any one of a number of works on the subject to ascertain the proper procedure. Up to the point of issuing full bottles of wines and liquors from the wine cellar to the so-called "service" and "stand-up" bars, there is no real difference in the method of unit control. Once the issues are made to the bars, however, we encounter a cost and sales situation which, in my opinion, is best controlled through the adoption of a detailed retail sales price control system, supplemented by frequent inventories of the bar stocks.

In order to set up such a system, it is necessary to first determine the exact liquid content of the glassware used for the various drinks offered in the wine list. What may be purchased for a two-ounce whiskey glass often proves to hold only one and three-quarter ounces. Sometimes there is as much as a half-ounce difference between the purchased size and the measured size of a whiskey, cocktail or wine glass.

Having once ascertained the liquid content of the glassware, the next step is to acquaint oneself with the policy of the restaurant client as to the sizes of drinks to be sold to his patrons. It will undoubtedly be found that this policy is determined by the character of the clientele, location of the restaurant and the ability to merchandise the wine and liquor items that appear in the wine list.

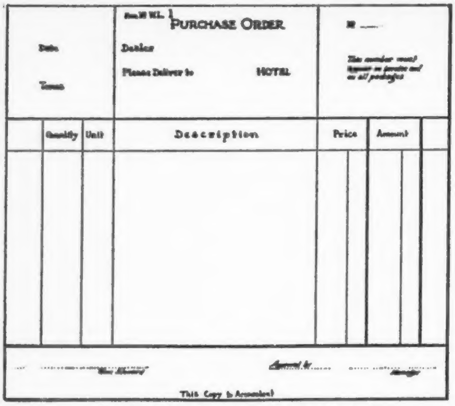
We can here marvel, perhaps, at the steadiness of a bartender's hand when pouring drinks and more so at his apparently unfailing accuracy in

never having a drop left over in the shaker whether he mixes one or even four cocktails at one time. Statisticians have not yet tabulated the losses to restaurant bars resulting from careless pouring, spillage and excess mixtures when making cocktails. If a bar drainpipe could only talk! All of this brings us to one of the most important liquor control factors—that of the accurate measuring of straight and mixed drinks. There is really an easy solution to this problem, namely, the use of bar jiggers, or one of the several mechanical measuring devices now on the market. The use of these bar utensils should be strictly enforced, unless it is a definite policy of the client to permit the patron to pour his own drinks. While no accounting procedure can effectively control such situations, the law of averages may be applied in that excessively large drinks are gradually reduced as the patron continues to purchase additional drinks. Although this is what might be termed psychological control, experience has taught us that the average bar patron is reasonably discreet in such matters. There are the exceptions, of course.

With the necessary data at hand respecting drink sizes, mixing ingredients, bottle contents, etc., a conversion table is prepared showing the retail value of each bottle of liquor issued to the bar. In addition, a table of differentials is prepared for drinks sold as highballs with charged water or ginger ale, or for drinks requiring the addition of fruits, milk, eggs, etc. The basic theory here is that each bottle of liquor should bring in at retail a sum equal to its total ounce contents divided by the ounce size of the dispensing glass multiplied by the wine list price of a straight drink of the particular brand of liquor. Usually, slightly higher prices are charged for highballs and fancy drinks and, for this reason, differentials for all such drinks sold are applied to the converted retail sales price of full bottles.

The various bars are charged with the stock issued from the wine cellar and, through frequent inventories, the exact consumption for any given period may be determined. As the result produced is shown in bottles and fractional parts of bottles, the liquor thus consumed is then converted into ounces. The next step is the pricing of the various items consumed at the wine list prices, the total of which, after application of the differentials, should equal the sales recorded for the period. It has been our experience that a variation of up to two per cent between the actual sales and retail sales value arrived at, is satisfactory under normal conditions.

A daily report form is prepared showing in detail the costs and sales of the various types of wines and liquors, and also a summary by bars of the actual and potential sales. I have here for your inspection a sample form of daily beverage report as used by one of our clients. It is from the information contained in these reports that management may ascertain which items and which bars are not productive of the proper gross profits. Furthermore, the value of such daily reports lies in the fact that the client need not wait until the close of an accounting period to be advised of the gross profit results. I might stress, at this time, that one of the more important features of a beverage control system is that the frequent reports submitted afford management an opportunity to take immediate corrective measures to curtail leaks and losses resulting from careless preparation of drinks, waste and theft.



Form № W.L. 1 PURCHASE ORDER

Date

Terms

Dealer

Please Deliver to HOTEL

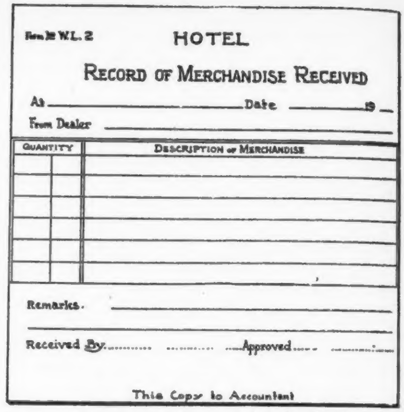
№

	Quantity	Unit	Description	Price	Amount	

Approved by

This Copy to Accountant

FORM 1



Form № W.L. 2 HOTEL

RECORD OF MERCHANDISE RECEIVED

At ______ Date ______ 19__

From Dealer ______

QUANTITY	DESCRIPTION of MERCHANDISE

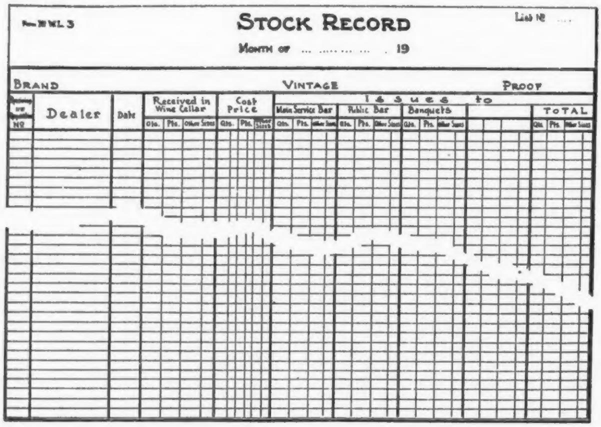
Remarks.

Received By.......... Approved..........

This Copy to Accountant

This Form in Duplicate, Second Copy for Wine Steward

FORM 2



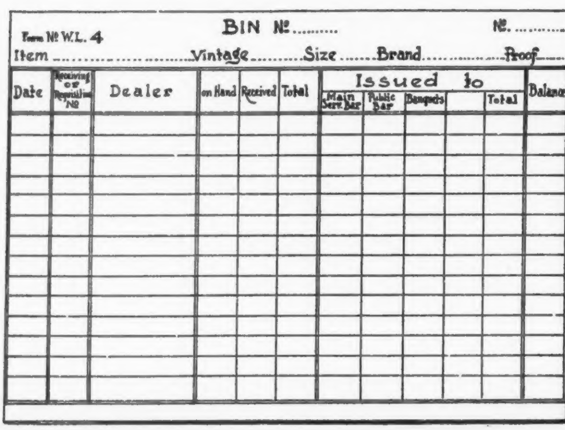
Form № W.L. 3 STOCK RECORD List № ....

MONTH OF 19

BRAND VINTAGE PROOF

Receiving or Requisition №	Dealer	Date	Received in Wine Cellar			Cost Price			Issues to: Main Service Bar			Public Bar			Banquets						TOTAL		
			Qts.	Pts.	Other Sizes	Qts.	Pts.	Other Sizes	Qts.	Pts.	Other Sizes	Qts.	Pts.	Other Sizes	Qts.	Pts.	Other Sizes				Qts.	Pts.	Other Sizes

FORM 3



Form № W.L. 4 BIN №.......... №..........

Item .... Vintage.......... Size....... Brand.............. Proof.......

Date	Receiving or Requisition №	Dealer	on Hand	Received	Total	Issued to: Main Serv. Bar	Public Bar	Banquets		Total	Balance

FORM 4

Form № W.L. 5 HOTEL №

DAILY INVENTORY, REQUISITION & ISSUE

Service Station № .... Date ....

Lot №	Description	Size	Standard Stock	on Hand	Requisition	Unit Sales Price	Amount at Sales Price	Issue	Remarks

.... Head Barman .... Wine Steward

.... Issued by .... Received by

This Copy to Accountant

This Form in Triplicate. Duplicate Copy to Wine Steward. Triplicate to Head Barman.

FORM 5

Form № W.L. 6 HOTEL №

BANQUET REQUISITION FOR WINES and LIQUORS

Name of Function, ________ Date ________

Room ________ Covers Guar. ________ Contract № ________

Time of Function ________

List №	Description	Quantity	Unit Price	Amount

.... Maitre d'Hotel .... Wine Steward

.... Issued By .... Received By

Use Separate Requisition for each Function. After each Function make up return list for Credits on Form № 6 A

This Copy to Accountant

This Form in Triplicate. Duplicate copy to Wine Steward. Triplicate to Maitre d'Hotel.

FORM 6

Form № W.L. 6A HOTEL № ________

BANQUET WINE AND LIQUOR RETURN LIST

Name of Function .... Date ....

Contract № .... Covers Guar. .... Covers Served ....

Banquet Check № ....

List №	Description	Units Returned		Unit Price	Credit Amount Full Units only
		Open	Full		

.... Returned by .... Received by

.... Checked to Requisition .... Wine Steward

This Copy to Accountant

This Form in Triplicate. Duplicate Copy to Wine Steward, Triplicate to Maitre d'Hotel.

FORM 6A

Form № W.L. 7 HOTEL

DAILY SUMMARY OF BANQUET WINE & LIQUOR SALES

Date ....

NAME OF FUNCTION (List Separately)	1. ISSUES AT SALES PRICE	2. RETURNS AT SALES PRICE	3. NET ISSUES AT SALES PRICE	✓	BANQUET CHECK №.
TOTAL					

.... Wine Controller .... Food Controller

Fill in Column 1 from Form № 6. Fill in Column 2 from Form № 6A (Full Bottles only)
All amounts in Column 3 must be Agreed with Banquet Checks Daily

FORM 7

Form № W.L. 8 HOTEL №..........

WINE STEWARD'S DAILY-REPORT

OF TESTS, SHRINKAGE, LEAKAGE & BROKEN MERCHANDISE

Date..........................

Bin No.	ITEM	Inventory		Test	LOSS		EXPLANATION
		Quantity	Unit Cost	Quantity	Quantity	Amount	

....
Wine Steward

....
Accountant

Tops of Broken Bottles must be Preserved intact for inspection.

This Copy to Accountant

This Form in Triplicate, Duplicate to Manager. Triplicate to Wine Steward

FORM 8

Form № W.L. 9 HOTEL No.______

DAILY REPORT OF FULL BOTTLE SALES

Service Station No.______________ Date ______

Check No.	List No.	Description	Quantity	List Price	Sales Price	Full Bottle Allowance
		TOTAL				

....
Head Barman

....
Controller

Each Sale of Bottled Goods Listed Above must be Supported by voucher

This Copy to Accountant:

This Form in Duplicate: Second copy to Head Barman

FORM 9

Form № W.L. 10 HOTEL №______

CERTIFICATE OF FULL BOTTLE SALE

Service Station №______________ Date ______

List №	DESCRIPTION	Quantity	Unit Price	Amount
	TOTAL			

Signed by

....
Barman

....

This Certificate must accompany the Daily Report of Full Bottle Sales – Form № W.L. 9

FORM 10

Form № W.L. 11 HOTEL №

DAILY REPORT OF VOIDS and RETURNS

Service Station № Date

Item №	Check №	DESCRIPTION	Quantity	Unit Price	Amount	Reason
		TOTAL				

Checker or Head Barman

Maitre d'Hotel or Headwaiter

Returned To

Wine Steward

This Copy to Accountant

This Form in Triplicate. Duplicate to Wine Steward. Triplicate to Service Station

FORM 11

Form № W.L. 12 HOTEL №

KITCHEN REQUISITION

FOR COOKING WINES, ETC.

Date

List №	Description	Quantity	Unit Cost	Amount

Chef

Wine Steward

Issued by

Received by

This Copy to Accountant

This Form in Triplicate. Duplicate to Wine Steward, Triplicate to Chef.

FORM 12

Form № W.L. 15 HOTEL

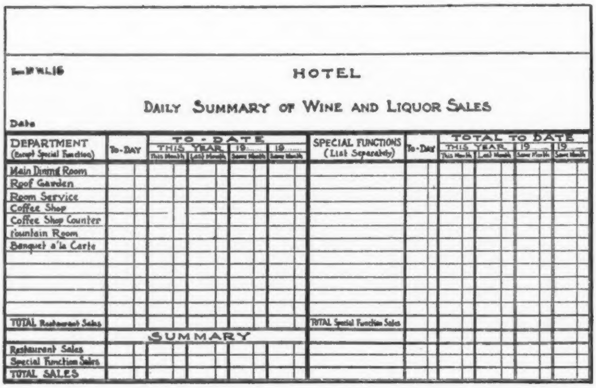
DAILY RECONCILIATION of WINE and LIQUOR SALES.

Date

Sales as per Requisitions	Issued to: Main Service Bar	Public Bar	Banquets		Total
Special Function (NET)					
TOTAL					
Less: Full Bottle Allowances					
TOTAL Deductions					
Net Sales per Requisitions					
TOTAL Sales per Registers & Cash Sheet					
Less: Voids and Returns					
Net Sales per Registers & Cash Sheets					
Net Sales per Requisitions					
Actual Receipts over or Short to-day					
Previous Overage or Shortage					
Overage or Shortage To-DATE					

Controller

FORM 15



Form № W.L.16

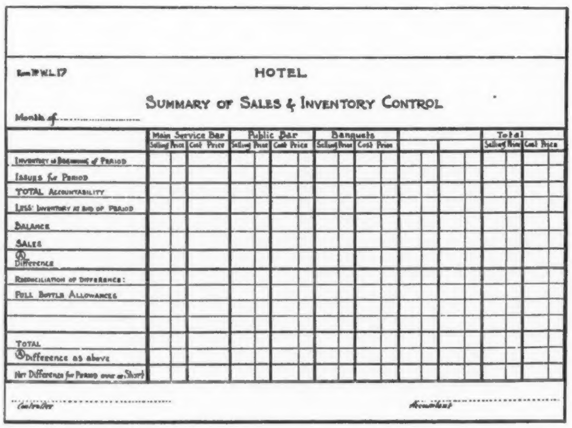
HOTEL

DAILY SUMMARY OF WINE AND LIQUOR SALES

Date

DEPARTMENT (Except Special Function)	To-Day	TO-DATE THIS YEAR This Month	Last Month	19.... Same Month	19.... Same Month	SPECIAL FUNCTIONS (List Separately)	To-Day	TOTAL TO DATE THIS YEAR This Month	Last Month	19.... Same Month	19.... Same Month
Main Dining Room											
Roof Garden											
Room Service											
Coffee Shop											
Coffee Shop Counter											
Fountain Room											
Banquet a'la Carte											
TOTAL Restaurant Sales						TOTAL Special Function Sales					
	SUMMARY										
Restaurant Sales											
Special Function Sales											
TOTAL SALES											

FORM 16



Form № W.L.17

HOTEL

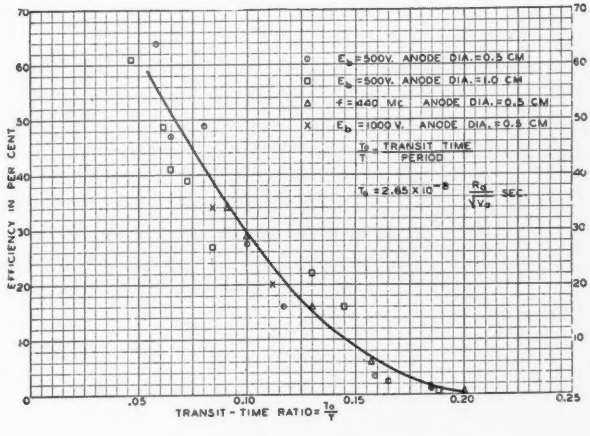
SUMMARY OF SALES & INVENTORY CONTROL

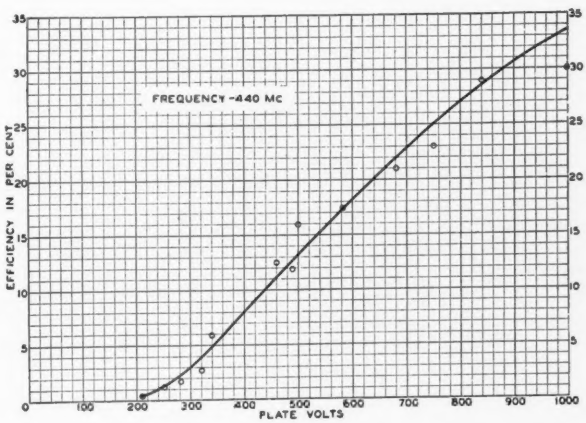
Month of..........................

	Main Service Bar Selling Price	Cost Price	Public Bar Selling Price	Cost Price	Banquets Selling Price	Cost Price			Total Selling Price	Cost Price
Inventory at Beginning of Period										
Issues for Period										
TOTAL Accountability										
Less: Inventory at End of Period										
Balance										
Sales										
(A) Difference										
Reconciliation of Difference:										
Full Bottle Allowances										
Total										
(A) Difference as above										
Net Difference for Period over or Short										

.... Controller .... Accountant

FORM 17


Eb =500V. ANODE DIA.=0.5 CM
Eb =500V. ANODE DIA.=1.0 CM
f =440 MC ANODE DIA.=0.5 CM
Eb =1000 V. ANODE DIA.=0.5 CM
To/T = TRANSIT TIME/PERIOD
To =2.65 X 10^-8 Ra/√Vp SEC.
EFFICIENCY IN PER CENT
TRANSIT - TIME RATIO= To/T
0
.05
0.10
0.15
0.20
0.25
10
20
30
40
50
60
70


FREQUENCY -440 MC
EFFICIENCY IN PER CENT
PLATE VOLTS
0
100
200
300
400
500
600
700
800
900
1000
5
10
15
20
25
30
35

Discussion on Beverage Sales in Restaurants

The following interesting discussion took place after Mr. Brodner spoke on the above mentioned subject:

A Member: What do you find is the average gross profit in hotel bars and also in the restaurant bars?

Chairman Brodner: Well, that question is one that we can hardly answer with one set figure, for the simple reason that you have the factor of the price paid for the merchandise bought, the wine list prices, the sizes of the drinks, and the number of free drinks given away, all of which go to make up the gross profit.

The cost per dollar sale may range from as low as 15 to 24 in night clubs to as high as 58 to 60 in an apartment hotel where bottle sales predominate. We used to think getting 30 to 35 in an ordinary restaurant bar was pretty good.

A Member: In arriving at the retail value of the liquor sent to the various bars, just how do you price these items, such as vermouth—ingredients other than the actual liquor?

Chairman Brodner: We make an actual test at the stand-up bar, for a certain period, have checks written for all drinks served at that bar, so we can determine seasonably or by certain days the various types of drinks that are sold. We then have to work it on a ratio basis. We know that on Mondays, with normal business, we sell a certain number of rye highballs, Bacardi's etc. Seasonably, we have the trend from heavy whiskies to gin in the summertime, and back to heavy whiskies in the fall and winter. Once knowing that, we can take all of the items on the bar and, based on our wine list and the ratio that we have pre-determined, know just about what we are going to sell. In other words, in the summertime we may dispose of, let us say, ten bottles of gin. We know that a certain proportion of those ten bottles of gin went for the making up of Tom Collinses, for which we should receive certain prices higher than the straight gin drink, and the remainder was sold at lower prices for straight drinks. The same applies to the bar; we know a certain amount of that was used to make Manhattans, etc. We price the remainder out at straight drink prices.

Same Member: In other words, you do not charge the bar with items such as vermouth that you use for mixing?

Chairman Brodner: Well, it is charged out at cost.

Same Member: I understand; but you do not charge that out at selling price?

Chairman Brodner: No.

Same Member: That is what I wanted to know.

Incidentally, what do you do when the same bar serves the dinner room or, in the case of a cabaret, they have one bar—one large bar—and that serves the main dining room as well as the bar, and the prices are usually 20% higher in the dining room?

Chairman Brodner: That is easily controlled because you have all that stuff written out on your check.

Same Member: How do you charge at the bar?

Chairman Brodner: Well, actually there is no real charge to the bar.

Same Member: Well, I believe you said in your paper that you use the retail value.

Chairman Brodner: Well, it is the consumption. The consumption of

that liquor is converted into retail sales prices, and knowing the consumption and what proportion that consumption the tables serve, you can immediately price that out. The remainder is then sold for stand-up services. Isn't that quite right?

Same Member: Well, I do not think it is just as easy as you explain.

Chairman Brodner: Well, let us, for example, say we have one bottle of rye and at the end of the day that is gone. In your night clubs you sold exorbitant priced cocktails. We deduct one quart and the remainder was sold at the stand-up bar. Convert that into the ounces at the retail sales price and you know the proportion of stand-up prices.

Same Member: It seems to me there is a lot of work entailed.

Chairman Brodner: Well, if you have got a night club that does any business at all, they should have that type of control, or some modified type of control that would show that result, because a night club generally introduces a 28% cost, or lower. He should be making 25 or 24, and, on a reasonable profit, that mounts up.

A Member: Isn't it true that where you do any substantial amount of liquor selling that it produces a very substantial profit in proportion to food?

Chairman Brodner: Well, let us not mix it up with food, now.

Same Member: No; I mean, the importance of control.

Chairman Brodner: The point is value. I feel that as far as the client is concerned he should get every cent of gross profit to which he is entitled; notwithstanding the fact that statistics might show that the average return is 65c or 68c, a distribution of his cost and sales and the size of his drinks, especially in night clubs where you are lucky if you get an ounce, might show that he should get a 19c cost. We have situations where 19c and 20c is the cost.

Same Member: Well, my experience is 30c.

Chairman Brodner: Well, that is a normal street bar, not a night club.

Same Member: No, I imagine it would be a lot less than 30c.

Chairman Brodner: That is right.

A Member: Where you have a date of control, do you take inventory every night.

Chairman Brodner: That also depends on the volume. We have situations where we take the controls daily, but that requires a pretty good clerical force. We take the inventories twice a week, in some instances, and in others we take them once a week. My personal opinion in that situation would be to take the inventory once a week—at the commencement, anyhow—and see how it works out.

Same Member: If you take it once a week, how do you get the date of control?

Chairman Brodner: Based on your issues and your sales.

Any more questions on the beverage situation? Mr. Wunderly brings up the subject of bartenders acting as their own cashiers. I would be opposed to it unless it were a matter of expediency and your volume of sales would not permit the hiring of a cashier.

A Member: On that question, I have come across this situation several times: The bar does not permit a checker to be in the center of the bar, which is the proper place for the checker of the bar. In other words, the checker, of necessity, because of the construction of the bar and the size of the room, is on the end of the bar, and the bar, say, is 30 or 40 feet long and the bartender has to

go from one end of the bar to the other in order to give the checker the cash or to take a check from him.

In those cases I have recommended that the bartenders take their own cash, have your machines right in the center of the rear bar and, instead of having a checker at the end of the bar where you can not see a thing, have him sort of supervise in front of the bar where he can watch more carefully than he can at the end.

Chairman Brodner: Do you use that same bar for table service?

Same Member: No.

Chairman Brodner: Just purely a stand-up bar?

Same Member: That is right.

Chairman Brodner: Well, I do not see what else you can do.

Same Member: He is away from the bar, he simply watches the bartender work. He may be 10 feet in front of the bar, standing up against the wall.

Chairman Brodner: Are the bartenders all within his vision?

Same Member: Certainly.

Chairman Brodner: Well, that is all right.

Same Member: In other words, he acts as a supervisor, not a checker. The bartenders do their own checking and own cashier work.

Chairman Brodner: You are carrying out my contention of the personal supervision being the best way of control.

Same Member: But you recommend having a checker there all the time.

Chairman Brodner: No, I am talking about a cashier. This business of a checker in a bar is pretty much useless because, if he was at a straight bar, as you say, he certainly could not see what is going on. If he was at one end, at a circular bar, he could not see what was going on unless he had eyes in the back of his head. There is really no spot where you can put a checker to supervise the bartenders. But I am speaking now of a cashier who collects the cash as it is collected by the bartenders.

A Member: Do you check the unit cost per quart or gallon; cost prices?

Chairman Brodner: You mean, how do we verify that?

Same Member: Do you check it?

Chairman Brodner: You mean the per-case price, and things like that?

Same Member: Yes.

Chairman Brodner: If you follow the forms on that sheet, it all starts out with a purchase order and individual receiving ticket, both of which eventually find themselves attached to the invoice which comes in for the merchandise. So we know what the price should be from the purchase order; we know that, as an independent, we received the merchandise, and we know that the stuff is in.

Same Member: I mean, do you make any attempt to see whether prices are in line with other markets, etc.?

Chairman Brodner: I do not think I would better answer that question. Well, it so happens that we are in a position (and I guess a great many of you are, having numerous restaurant clients) to know what the general market is on liquor, but you know also if you tell your client who buys any particular brand that he is paying $2 a case too much, and that if he goes to the dealer and makes that statement, the dealer turns around and goes to his cus-

tomer who is getting that $2 "break" and tells him he will have to pay $2 more, and that fellow may be also one of your clients so you get it both ways.

Are there any other questions on the beverage situation?

A Member: In determining your inventory, how do you arrive at the remaining cartons and empty bottles?

Chairman Brodner: Well, there are several methods. There is the "hit and miss" method, and then there is the strip tape method.

Generally, with popular brands that are used, they have a uniform shape of bottle and even if they are not, by setting a strip of paper up against an empty bottle and taking a measuring glass you can mark out on that particular bottle the various ounce sizes, and by having those run out on a mimeograph machine and cutting them out in strips you can take your mechanical inventories.

A Member: Is there any mechanical bottle on the market?

Chairman Brodner: I do not know, but I did see this: something that was just a wooden stick and it had graduations on each side, one for quarts and one for fifths, so by standing your bottle against that you could measure them. That is a home-made method and quite useful.

A Member: If you use tapes do you find that affects the inventory at the bar?

Chairman Brodner: If you use tapes you have it exact.

Same Member: I see.

Chairman Brodner: In other words, if you take any empty Scotch bottle (take one when you go home tonight, for example) and stick it against the bottle, pour out a glass and mark it on the tape—two ounces, so on, up, and the half ounces between—if you take that out and have your stenographer put that on a strip 8 x 11 you can make ten strips out of that and make a measuring gauge.

Same Member: I imagine you would have to spend some time measuring each bottle.

Chairman Brodner: No; you will find a great many popular brands use the same bottles. It is only when you get into the liqueurs and fancy brandies that you get the fancy bottles.

A Member: In determining the gross profit, how much would you allow for free drinks?

Chairman Brodner: I would not allow anything for free drinks.

Same Member: Well, most bars do.

Chairman Brodner: If that is part of the policy you can almost tell about how much is given away.

Same Member: You would have to get that from your experience, then?

Chairman Brodner: That is right, except that in a stand-up bar which does not make a check we have to make various tests of the different kinds of drinks sold. It is not as though you had so many suits or shoes that you could really work on.

A Member: In connection with that, I have found a great deal of success in accounting for free drinks by having the bartenders keep a blank sheet of paper or a blank pad right underneath the bar, and every time they give a free drink put the retail price of that down. And they keep a daily record of what the value of the free drinks is.

Chairman Brodner: I think if you can get the bartenders to do that honestly, it is a very good idea.

Same Member: In other cases where we have had difficulty in that line, no bartenders get free drinks except by permission of the supervisor.

Chairman Brodner: That is all right, but the minute when the bartender goes to the supervisor and says, "John Jones has had five and I would like to give him one," of course this "bird" may be so tipsy he does not notice, but it is pretty embarrassing if he notices that the bartender has to go to the manager to get permission for a free drink.

A Member: In reference to a stand-up bar where you have one or two bartenders and you have the proprietor watching the bar at all times, I am convinced of the value of a cashier for this reason: the bartender usually makes his check out, and what value then does the cashier have inasmuch as it has been made out by the bartender?

Chairman Brodner: You are speaking of a bar where you write the check out and the owner's right there?

Same Member: Yes; the owner is usually standing at the other end of the counter.

Chairman Brodner: I would not have a cashier at all.

Same Member: You would recommend a cashier, then, where the proprietor or original manager is at the bar?

Chairman Brodner: If you went down to the Commodore bar (you have been to the Commodore bar; it probably does the largest business of any bar in the city), no supervisor could possibly control that situation down there, but they have had to cut niches out of the wall so the cashiers can sit in there, and they have them spotted all along that bar so they act both in the capacity as checkers and cashiers.

I think that each one of the cases requires its own treatment. It requires personal observation to see what the possibilities for theft are and then you can make your control, because in hiring a cashier for $75 a month they have got to steal a lot to make up for that. You might let them pick their share and not engage the cashier.

Same Member: At just what particular point would you recommend a cashier? He is a watch-dog at the same time, otherwise I cannot see the value of a cashier.

Taking that system which the client recommended to you and which I think is good—where they write out the popular drinks and then write in any other drink—now he is circling that; he might circle a cheaper drink, however, and pocket the difference, but even if he did that there would be a question as to the honesty of the bartender. I am not certain, therefore, of the value of a cashier, unless you put him in there as a watch-dog.

Chairman Brodner: It is always hoped the cashier will act in the capacity of a checker. The only question is, how efficiently he acts as a checker. He cannot possibly see everything that goes on—not one man, anyway.

A Member: Out to the Fair, for instance, some of the busiest bars gave up their cashiers because they found they were slowing up their service to a point where it was better for them to do away with them. The Schaefer bar did not have cashiers, and several other very busy bars did not use cashiers.

Mr. Ernest E. Wunderly: At the French restaurant they used cashiers.

Same Member: I am talking about the very busy street bars, like Schaefer's.

Chairman Brodner: Of course with most of them sales of beer were the big thing. In a bar that did that much business I would definitely have a cashier—if there were a heavy volume of whiskey sales—but where you have a tremendous volume of beer sales, as they had at Linnegan's and places like that, with the Dutch beer being 20c, there was not much a bartender could get away with and he had to pretty much ring up the sales as he made them. But if you had that many transactions and they were whiskey, I would recommend a cashier, if not more than one at a time.

Mr. Wunderly says Ballantine's had their bartenders acting as cashiers. You will notice that Ballentine's, Linnegan's, etc., were all primarily beer dispensers.

We like to see the records kept independently. In other words, for a wine steward to do all his pouring on bin tags. Independently of that, the auditor's office should keep a record. That is that third form in the upper right-hand corner, and independent record is kept in the auditor's office, and the beauty of that is that any time in the month the man in charge of that record in the auditor's office can walk down to the wine cellar and turn to any cask and make a physical control and test of any bin in the wine cellar. In other words, all the entries should be the same on the bin tag, and the merchandise should be on hand.

The Restaurant Profit and Loss Statement

By Benjamin Wassner, C.P.A.

The following address was delivered by Mr. William K. Borow, in the absence of Mr. Wassner, who was called out of the city unexpectedly. George S. Nutt, Vice Chairman of the Committee on Restaurant Acccounting, presided at this part of the forum:

The paper I read is the opinion of Mr. Wassner and is not my opinion except where we agree.

My topic for discussion tonight is "The Restaurant Profit and Loss Statement." As I am not one of the "Old Timers" I cannot say that I remember when every restaurant had a form of its own different from the one in every other restaurant; I do not remember; but I do know that such a condition existed less than fifteen years ago. When I started to look up the subject I was surprised at the multitude and variation of forms. It certainly was a good thing for all of us that The National Restaurant Association in cooperation with one of our leading restaurant accounting firms adopted a standard form and so finally made it a simple matter to compare profit and loss figures when submitted by different organizations.

This form is now the most common used, but it is by no means the only one popular among restaurant executives.

Briefly described, the form is divided into two sections — dollar amounts and percentages. Each section is further divided under the following four headings: (1) Food Sales. (2) Beverage Sales. (3) Tobacco Sales. (4) Total Sales. The major subdivisions of the statement are Sales, Cost of Sales, Gross Profits. Other Income, Total Income. Expenses, and Net Profit on Sales.

The expenses are classified into Payroll, Operating Expenses, Maintenance, Rent, etc., and Executive Office Expenses. Payroll includes only the cash payment and not

meals, usually, although I like to include the cost of meals here, using two figures for payroll, calling one Payroll — Paid in Cash, and the other Payroll—Cost of Employee's Meals, at the same time deducting this cost figure from our Cost of Sales Total, never added to our Income from Sales as Income from Employees Food Sales as I have seen it now and then.

Operating Expenses include such items as Laundry, Fuel for Cooking, Electricity for Lighting, Ice and Refrigeration, Stationery and Printing, Taxes and Licenses, etc.

Maintenance includes China and Glassware, Silverware, Linen, Kitchen Utensils, Repairs, Uniforms, etc.

Under Rent, etc., we list of course Rent, also Water, Heat, Insurance, Depreciation and Amortization of Leasehold.

While it will be admitted that the aforementioned statement form is far from perfect, it must be readily acknowledged that it lends itself most easily for comparison with statements of the most varied types of restaurants.

I might mention that the expenses are not allocated to the various types of sales such as Rent apportioned to Beverage, Food or Tobacco Sales and so forth, but are reported in the total columns only.

Another form of profit and loss statement used is one usually seen by the owner of the smaller type of restaurant, one in which the cashier serves the double purpose of taking cash during rush hours and entering up the books during the lull. It is the ordinary P. & L. arrangement common in any retail organization.

Sales are broken down into Food, Wines and Liquors, Beer, and Tobacco. These figures are generally copied into the sales book directly from the cash register totals and are therefore quite simple to ascertain.

May I digress a bit at this point and mention that in this form the emphasis is placed on sales analyses rather than in the expense analyses as in the previously mentioned standard form. The reason for this is obvious when you remember that the State liquor authority requires that only food sales and bar sales be shown separately, whereas the New York City Sales Tax Department comes along and says, "We do not care how much business your bar does, just tell us how much wines and liquors you sell so we can get our three per cent, and how much tobacco you sell exclusive of cigarettes so we can get our two per cent sales tax on that." So you see that the greater the breakdown of sales you have, the easier it is going to be to prepare your sales tax reports. Of course, it is a comparatively simple matter to arrange our purchases and opening and closing inventories in the same manner as our breakdown of sales, and so we can get our most valuable percentages—cost of sales—for each type of sale.

The distribution of expenses is merely a listing of them in the order of importance. Payroll usually heads the list and is followed by Rent, Light and Heat, Taxes and Licenses, China and Glassware. Linens, etc., all of course with percentages extended. This is the form of expense distribution usually seen where the manager or proprietor prepares his own statement before the accountant comes around to make his audit and submit his report. It is the simplest and most easily understood by most managers.

Now here is the third form which I wish to take up. It is one which I understand is used extensively in the West, but for some reason or other cannot seem to be able to get across the Rocky Mountains. In this form, sales, cost of sales, and gross profits may be shown either as in the standard form or as in the second form which I discussed.

However, an interesting and very valuable distribution of expenses is made. These are divided into only two categories—Controllable Expenses, and Non-Controllable Expenses. Under Controllable Expenses we list such items as Payroll, Replacements of Silver, China and Glassware, Gas, Electric, Heat, Advertising, and so forth. The most common non-controllable expenses are Rent, License Expense, Insurance, Legal Fees, Depreciation, Amortization of Leasehold, and similar items.

Of course, a certain amount of confusion arises in the distribution of some expenses such as payroll taxes or similar items. While it is true that payroll taxes are definitely in themselves non-controllable expenses, the fact that they are based on a controllable expense like payroll might make the treatment of this item questionable. However, once having decided upon its classification, the report serves its purpose so long as the expenses are kept in the same category consistently.

The advantages of this method of reporting P. & L. expenses are easily recognizable. Non-controllable expenses are just glanced through and compared in total with the previous periods to see if there is any change (usually there is very little), and all of our attention is focused on controllable expenses—those expenses which management can do something about. There is little use in looking at the rent, depreciation and license cost each month, we cannot do a thing about these items, they are fixed—but the controllable expenses, separated so that they stand alone, here is something management—good management—can follow up and concentrate on.

Although this form of P. & L. statement is the one most clients may prefer, it does entail a little additional work in rearranging the expenses so that they can be compared with those of the standard form, as most of the percentages in statistical analyses are based on that form.

The most common question asked in any general discussion of restaurant accounting when P. & L. statements are mentioned is usually, "To what percentage of sales does labor generally run?" or "What is the average cost of sales?" and so on, and so I thought that in the few minutes I still have allotted to me I could mention some of these averages. You must bear in mind that every restaurant operates differently, that one restaurant pays more rent in order to save on advertising and food cost, that is through a greater sales volume effecting savings in cost; another restaurant will try and save a little on the rent and either give larger food portions or spend a little more on some special service such as music and entertainment. These factors must all be taken into consideration when studying the percentages most commonly found. However, a fairly representative restaurant doing in the neighborhood of $5,000 to $6,000 a month will show about the same percentages, on the whole.

The first and most important of these percentages is the cost of food sold. Now I have seen restaurants make money with a 63% food cost, and I have seen them lose money with a 35% food cost, but, as I said before, on the average you will find that food should cost about 48% of sales when neither liquor nor beer is sold, and about 40% where these beverages are popular.

Labor is next in importance. Again, I have seen restaurants making money and yet paying as high as 28% for labor, and others losing money with only a 15% payroll cost. However, about 20% seems normal.

Rent is another item that is asked about. I know of places paying 10% and doing nicely, and others, while

paying only 3%, cannot meet the rent when it comes due. However, 5% is the average paid.

These three items are the most important ones to consider when going over the costs, and if the total of them can be kept under 70%, your profit and loss statement will generally bring a smile of satisfaction to the face of your client and that, after all, is our goal—just to bring a smile of satisfaction to the face of our client when he reads our profit and loss statement.

Discussion on Restaurant Profit and Loss Statement

Questions Directed to Mr. Borow:

A Member: I was not here before and I do not know whether this question has been taken up:

In restaurants, where they sell both beer and liquor and they have one register in which to deposit money, of course only the liquor is taxable. What has been the experience with the members here as to what the Sales Tax Department does with that?

Mr. Borow: You take your purchases of liquors and figure out your conversion factors; so many sales should account for so much liquor purchased. The Sales Tax Department will agree with you provided those compare favorably with other types of restaurants and bars, as you talk about. That has been my experience. Has it been yours?

Same Member: Do they have that standard percentage?

Mr. Borow: Well, the average bar will gross around 65% to 70% on net sales of liquors; that would be the average percentage. In other words, inventories have no bearing at all in the equation so far as the Sales Tax Department is concerned.

A Member: Would you please tell me whether the figures quoted from that paper, if you know—cost of food sold—48%—whether that includes the cost of employees' meals or not?

Mr. Borow: As a matter of fact that includes the cost of the employees' meals.

Same Member: Don't you think he is rather low at 20% for labor? I remember Dun & Bradstreet, a few years ago, made quite a survey, and it seems to me they never quoted 20%. Even the various sales volumes they quoted in their statistics.

Mr. Borow: Well, in New York, it will be 26% to 28%. Something like that. Twenty-four would be exceptional; 24 is what we would say is the best percentage you can get today, but 26% would be an average, I would say.

A Member: That is why they are losing money.

Mr. Borow: Well, you have got union conditions to contend with today. They are not all making money today.

A Member: I have some clients in nearby towns where, as soon as one fellow reduces the price of a dinner from $1 to 75c the whole flock follow, regardless of what they serve, the rent they pay, quality of service, or anything else. People's eating habits vary, of course. Sometimes you put an ad in the paper and they have the crowd flocking to that fellow. They will say, "You put an ad in next week, and they will all flock to you."

Mr. Borow: You are talking about small-town restaurants.

Same Member: No, fair-sized. Take Montclair, for instance.

Mr. Borow: Well, there are not so many in Montclair, are there?

Same Member: No.

Mr. Borow: Let us assume you reduce your volume 25%. Your volume of sales would go on, and if you do not reduce the cost of sales you are not going to only take it on reduced volume and reduced cost, you are going to find he is going to have to go "behind the eight-ball."

Let us say it costs him 45c for food costs and he sells that meal later on for 90c or 80c; he is going to reduce that gross profit and he must have less profit to cover his overhead.

Same Member: But in a situation where it is a fight of capital between one and another and the costs cannot really be matched out against what I call "national averages."

Mr. Borow: You cannot do anything about that. When a cafeteria is on the corner of Broadway and Thirty-sixth Street and somebody takes the next building and has another one, somebody has got to "take it on the chin" unless the other fellow closes up.

A Member: In your opinion, what is the cause of most of the bankruptcies of these restaurants? I have in mind this fact: in many cases I come in for credit; the place closes up and I have to come back for a report. I woud like to put the question this way: Isn't it your opinion that, with most of these restaurants closing up, one factor is the fact that they are under-capitalized? (I am talking about the restaurants that start in one year . . . .).

Mr. Borow (Interrupting): Well, there is no question but that most cafeterias (we will speak of cafeterias because it isn't the case as much with restaurants)—the cafeteria man goes in with no capital; he is financed by the fixture man, the coffee man and the milk man, etc. The result is, as I explained at the last meeting, his profit and loss statement is according to the third method. That is, we take the control of income and control of expenses and set them up that way. Then, as I explained last time, we take the executive officers' expenses as a separate item. Then, after that, we arrive at a P. & L. In our P. & L. if that amount remaining for net profit does not cover (now we don't consider depreciation; we will forget that for awhile)—does not cover the amount of mortgages or notes he has to pay over the period, he is losing money. His money is dwindling to a point where he has no cash on hand to pay his current obligations. That is what you have in the restaurants of New York, to a large extent.

Same Member: In one of the largest restaurants in the town the proprietor showed me the figures of that concern and told me the mortality rate among cafeterias is 50%. I gave him that opinion and wanted to get your reaction.

Mr. Borow: There is no question but lack of capital is the big factor; then you must not forget we have, particularly in this city, certain coffee merchants and milk merchants who do a lot of financing and usually have these mortgages, and they are always protected, and the man who "holds the bag" is usually the vegetable man, the groceryman, and bread man sometimes, because the bread man comes in with the coffee man lots of times, and you will find that the grocery business is the one that is going to suffer most. But when you come to compare prices you will find that the groceryman can buy a lot cheaper than the restaurant man can. In other words, the wholesaler is really adding a burden to the selling price, so that the restaurant man is really paying for that risk.

A Member: You mean, his margin allows for that risk?

Mr. Borow: That is right.

A Member: I think I can help you handle the gentleman's question with these few words: that, in addition to the item that you have mentioned, the difficulty with the restaurant industry is that there are too many ignorant people in the business. You will find that most restaurant operators are "graduate waiters."

Mr. Borow: Countermen.

Same Member: No, really waiters in the service places, and a great many are graduated countermen.

In addition to that, the business is so easy to go into you get a lot of people, being in the other businesses, going into the restaurant business because it seems to be such an attractive business—it is a cash business—and, in addition thereto, when it comes to a question of capital, you will find very often a restaurant operator will invest, say, $10,000 or $15,000 in a large cafeteria, and when he opens up he will use the receipts of possibly the first month or two of business to help finance the building of the store, and he is all right—he is in good financial condition if he does that—provided he does not lose money immediately, and if he loses money it will probably carry him six or eight months before it "catches up with him." But if the same restaurant operator had invested all the cash that was required to pay the down payment on his fixtures and all he did was put $1,000 in the bank, even in a very large operation he would find that he had plenty of cash and would be able to survive even one year of bad business.

I think the gentleman who is the auditor for some grocery houses underestimated when he said there was a mortality of 50%. If you go further—into two or three years—about 95% of them will close within three years.

Mr. Borow: There is another factor that goes into these things that you cannot control, sometimes. You take where a restaurant may be located in a business district, catering to a particular trade, for instance the shoe trade—the textile trade—and there is a strike for a period of time; you will find the restaurants will close up during a slow season.

The reason why most of these restaurants close up (particularly in this vicinity) is lack of capital. They actually go in with 10% capital and 90% mortgages. You take the International Casino; it did the same thing.

A Member: There are wholesalers in there, now. They tried to carry it a second time, and now I think they are through.

Mr. Wunderly: I think it is the third time, now.

Mr. Borow: Well, there have been changes many times in those places.

A Member: From your experience, what would you say would be a fair amount of capital to start with if he intends to invest $20,000 in fixtures to operate a bar and grill?

Mr. Borow: Well, that is a ticklish question, depending also on circumstances; but I would say that if I wanted a client to possibly exist and he is operating a place that cost $20,000, if he put up 50% of the cash capital himself; and even though he does not put it all in the fixtures, he would be also taking a good risk.

A Member: Do you mind if I disagree with you on that?

Mr. Borow: Go ahead.

Same Member: I have not disagreed with you on many things, but I do there. You will find today that contractors want anywhere from 40% to 50%; say 40%. Now there are a good many fixtures that you have to pay for in full. There are a good many items such as advanced sureties on rent, license fees, gas and electric—all have to be paid

in full—so if you say an operation will cost $20,000, I think it would be safer to take 60% to cover the items that would be paid in full—$12,000 plus at least $1,000 in the bank when he starts.

Mr. Borow: We are just talking about a little 10%, but you know it all depends on the circumstances. We have a case where a restaurant was bought for approximately $40,000 and the initial payment was supposed to be $12,000, leaving a mortgage of $28,000. We know our clients went in there for a trial period of a week. Immediately you buy a place you have to look forward to an alteration. Am I right?

Same Member: You are right.

Mr. Borow: They took in $7,000 cash and took in enough the first week or so to more than pay the balance of the $5,000, and kept on making profit, so that today they are a very successful restaurant, taking over somebody else's "headache." (I say that because we know the other people managing the place lost money.)

So you cannot say it depends on the amount of capital a man comes in with, it depends on the management, the location, and certain conditions. We find in many cases where a man will go in with the milk man and say to the other fellow, "Come on and take this place over; we will even lend you money to open up that place." We have numerous cases where that has happened, where this particular management has gone in and made profit locations where there were loss locations. I would still say, however, I would like to see a client put up at least 50% of the amount of cash capital that he expects to spend for fixtures and leaseholds or anything else that would go into it.

A Member: Did you say 5% for rent?

Mr. Borow: The paper says it may vary from 3% to 10%; however, the average paid is 5%. That is approximately more or less right. It might be 6% and, as he said, here, 10% is considered high.

A Member: I would like to say in connection with the percentage of rent, that in my experience places that sell liquor and food have percentages running from 8% to 10%.

Mr. Borow: That is right.

Same Member: I think 5% is a little bit too low.

A Member: I would like to know what record is kept of paid meal tickets in advance.

Mr. Borow: I do not understand what you mean.

Same Member: In some large restaurants on Broadway, they sell to ticket brokers books of tickets in advance for a discount in advance.

Mr. Borow: Well, I have not had much experience with that. I will let Mr. Wunderly take care of that.

Mr. Wunderly, what do you think of the due bills?

Mr. Wunderly: Well, the hotels get quite a few due bills, too, but they usually number the due bills, say for a hundred dollars or so, and they set up a liability for the due bills, say for $100, and if it is for advertising (and it usually is) they set up deferred advertising for $100 and as the advertising appears the deferred charge is written off, and as the due bills are used the liability is written off.

Does that explain it?

Same Member: Yes. Thank you.

Mr. Borow: Well, particularly I think that in those night clubs that sell these due bills, a lot of them, as a matter of fact, won't make any records of them at all. They expect some day they will pay them or some day they won't.

A Member: I noted that the writer of the paper mentioned that in restaurants doing between $5,000 and $6,000 a month, a food cost of about 40% could be anticipated.

Mr. Borow: No; 48%.

Same Member: Forty-eight per cent.

Well, how does that fit in with your own experience?

Mr. Borow: Well, from our experience it seems to depend on the type of restaurant, etc. In cafeterias, working from 45% to 50%, that is doing fairly well. Certain cafeterias, let us say of the dairy type, if they work between 40% and 45% gross cost, that would be doing well.

Same Member: How about a restaurant which is serving liquor?

Mr. Borow: That can vary depending on the type; but a restaurant serving liquor will be about 40%, don't you think so, Mr. Wunderly?

Mr. Wunderly: About 45.

Mr. Borow: Yes, around that figure.

A Member: A restaurant serving liquor?

Mr. Borow: Yes.

A Member: Why didn't you differentiate between the two? Because I find that restaurants that sell a lot of liquor usually lose money on their food. If they have a 10% gross profit or a 90% food cost, they consider themselves doing well.

Mr. Borow: Well, it all depends on what you call a restaurant, then.

Same Member: Well, it is a restaurant.

A Member: I would like to say this: I note, in several places, where they sell liquor and also food—$4,000 a month food and $10,000 a month liquor—the food costs run about 55% to 57%, and the liquor costs are way down—they run between 35% and 40%.

Mr. Borow: You see you are getting a percentage there of 3 to 1 as far as liquor and food are concerned. That is not the usual case, though, in a service restaurant.

I think the food is only incidental to the place. They are not interested in the food at all, just using the food to have a license profit.

Same Member: But $4,000 or $5,000 on food is quite an item.

Mr. Borow: Well, yes and no.

A Member: Do you attempt to control employees' meals in cafeterias and service restaurants?

Mr. Borow: Very seldom. Very few restaurants control the employees' meals.

Same Member: The reason I raise the question is because I have a restaurant in mind that sells $25,000 a month in food. I took the question up with him and he laughed at me. He said, "You want to control it? How do I know, when she takes a glass of milk, she doesn't use half cream and half milk?"

Mr. Borow: That is right. It is not tried in any particular type of restaurant, but in some old service type of restaurant which will limit the employee to the amount of food. There are also cafeterias which will limit the employee to a certain amount.

A Member: The Willow chains.

Mr. Borow: Yes, they did that, too. They did that! Do you get that?

A Member: In reference to supplies, how do you write off the expense?

Mr. Borow: If the supplies are of large enough an amount you would take an inventory of them. If you buy them as you go along in small quantities, you would write them off as they occur.

Take checks. Checks could be written off six months in advance.

You are not going to put them all on one month's expenses for supplies, you would pro-rate them over six months. Ordinarily, restaurants buy their supplies from time to time, knowing about how much they would keep on hand all the time.

Same Member: In that case do you carry a flat amount and charge off whatever they buy?

Mr. Borow: Yes.

Same Member: Well, I find in my experience you can take the total purchases for a month and that would last four months. It is pretty difficult to take an inventory of supplies.

Mr. Borow: You can get napkins within twenty-four hours, as a matter of fact within two hours, can't you, in any restaurant? You see your method of every four months might be all right but it does not take into consideration supplies compared to volume. The same thing applies with dishes and utensils. You might buy a quantity at one time and replace it in six months. You would not know what your client's intentions are; does he expect to use them over a period of six months or throw out all the old dishes and use them at one time? Wouldn't that be the case?

Same Member: Well, in the case of a restaurant which has to buy them all at one time you would spread that over a period of time, wouldn't you?

Mr. Borow: We spread that over a period of time and charge that to an expense.

Same Member: On a payroll, a successful restaurant man told me that a standard base, if you want to call it that, should be that a week's payroll should amount to a day's business. Figuring on a day's basis it would come out to 16⅔%. I notice you said 20% was a fair average.

Mr. Borow: No, I never said 20%. I would say 24% to 26%. If anybody should tell you one day's receipts would suffice for the payroll he would be doing very well, wouldn't you think so?

A Member: Exceptionally well.

Tax Problems in Connection with the Sale and Acquisition of Restaurants

By George S. Nutt, C.P.A.

The topic that is assigned to me is, "Tax Problems in Connection with the Sale and Acquisition of Restaurants." It was assigned to me because the Committee felt it might be of general interest. I trust that in the brief time allotted to me I may clear up some of the questions that are usually asked the accountant by a seller of a restaurant who has an offer in excess of what he paid for his property, viz., "How much of my profit will be taken by Uncle Sam and the State of New York?" and when that information is given (usually with reservations, expressed or implied), the next question is, "How can I handle the sale to reduce that tax?" It is a legitimate question and if we accountants can answer that second question to the satisfaction of our client, our fee will be that much greater.

I might say that if any of you fellows want to walk out, it won't embarrass me in the least. If you're not interested in this particular

phase of the question you're perfectly welcome to leave.

A business transaction can be handled one way and result in paying a considerable tax. The same transaction can be carried out in a different manner, taking advantage of certain provisions of the Internal Revenue Law, and result in a much smaller tax, and also the postponing of a tax on a paper profit until the profit is actually in the possession of the seller in the form of cash. A striking example of the above is being handled at the present time in our office. Two of our clients, stockholders in a steel company, are facing assessments of approximately $100,000 because the attorneys and accountants of the steel company gave the wrong advice when the company sold its assets to a larger steel company. A legal step was taken at the request of the larger steel company which was thought to be of no importance whatsoever, and apparently that one step is going to cost the stockholders of the smaller steel company over a million dollars.

Let me say, at the outset, that the tax problems connected with the sale of a restaurant are in nowise different from the sale of other real and personal property, e.g., the sale of a furniture factory, an expensive piece of machinery, etc.

Perhaps, if I give you a concrete example of the tax in the sale of a restaurant handled in one manner as compared with the tax on the same sale handled in a slightly different manner, the facts and methods will be more impressive and will be remembered longer than if I talked in terms of revenue law.

A owns a restaurant, i.e., has a lease which will not expire for some years, and owns the usual equipment, linen, china, tables, chairs, kitchen equipment, all of which cost him $50,000 correctly capitalized on the books. This has been reduced by depreciation to $30,000. A is offered $60,000 for his business—$20,00 cash and the balance in a series of notes running over a period of five years. He accepts the offer. We assume that A is a married man with two dependent children and has in the year 1939 additional income of $5,000. His Federal income tax for the year 1939 would be $4,579 and his New York State income tax would be $2,286, a total of $6,865. He is ready to retire and has no income during the five-year period that the notes are being paid by the purchaser at the rate of $8,000 a year.

Now if A had asked you, his accountant, the second question I mentioned above, viz. "How can I handle this sale to reduce this tax of $6,865?", you could, if you were familiar with the provisions of the income tax law, have said, "Take $18,000 in cash and the balance in five notes of $8,400 each instead of $20,000 cash and five notes of $8,000 each." This immediately brings the sale within the provisions of the installment sale provisions of the revenue law and the total tax over the six-year period, assuming the same conditions as above and that the revenue laws do not change, would be $885.00 Federal tax and $741.00 New York State tax, or a total of $1,626.00, resulting in a net saving in tax of $5,239.00.

All that you did in the above case was to change slightly the manner in which your client received his $60,000 over a period of five years—a little less in the year of sale counterbalanced by a little more in each of the five succeeding years. By so doing you brought the sale within the provisions of the installment sales section of the revenue law. This provision means simply that instead of paying your tax on your entire profit in the year of sale, you pay the tax on the profit as you get it.

What constitutes an installment sale of a restaurant?

1. The cash (or other property, not including evidences of indebtedness such as notes, mortgages) received in the year of sale must not exceed 30% of the sales price.

2. The books must be kept so as to reflect income on an installment basis.

3. The sale price must be over $1,000.

A few other provisions of the revenue laws must also be taken into consideration in considering installment sales.

A. There is not much advantage in a corporation using the installment sale method of reporting income, because no longer is the first few thousand of income exempt from tax, and also because the tax is no longer graduated unless you run into the excess profits tax, or the income is less than $25,000. In the case of a corporation making a sale of a restaurant, it might be advisable to liquidate the corporation and let the stockholders run the business as a partnership (or as an individual) for a reasonable time before making the sale. If sufficient time elapses between liquidation and sale to show that there is no connection between the two events, a substantial corporation income tax on the sale can be eliminated.

B. It is possible to sell some of the notes given by the purchaser to a third party in the year of sale of the restaurant, getting thereby in that year more than 30% of the sales price in cash without sacrificing your right to report income on the installment basis.

C. If there is no cash or property (not including notes, mortgages, etc.) paid to the seller in the year of sale, the installment basis cannot be used.

D. The law provides that if the evidences of indebtedness (notes, mortgages, etc.) are disposed of—by sale, by gift, by death of the seller, or in any other way—the entire remaining profit on the deal that has not been taxed must be reported as income in the year of such disposition. But again, there is a loophole, viz., if the party who acquires the evidence of indebtedness by death will put up a bond, he will be permitted to continue to report on the same basis as the original owner of the indebtedness, viz., on the installment basis.

E. If A had owned real estate (land, building and the other equipment), the capital gain and loss provisions of the Federal revenue laws would apply to the profit on the sale of land. A recent change in the Federal revenue law takes depreciable assets out of the provisions of the capital gain and loss sections. New York State went one step further and no longer considers land as a capital asset if it was used in a business.

There are other tax problems involved in the sale of a restaurant which I can merely mention in passing, as time does not permit me to discuss them:

A. The problem if the buyer fails and the seller has to repossess the property. In its simplest terms, his gain or loss is measured by the difference between the value of the property at the time he repossesses it, and that part of his original cost that has not been recovered.

B. The method of arriving at the proportion of profit to report each year when there are mortgages on the property at time of sale which are assumed by the purchaser. It involves the determination of the "total contract price" which is the sales price less the face value of the mortgage assumed—with one exception which is not important and which might serve to confuse if I mentioned it.

C. The loss on the sale of a restaurant must be taken in the year

of the sale and cannot be spread out over a period of years, even if all the other conditions of the law are met.

D. The difference between reporting profit on an installment sale basis and the deferred sale basis.

E. The problem if the property sold was acquired before March 1, 1913, the date the income tax law became effective.

I have not touched at all upon the tax problems involved in the acquisition of a restaurant, as I believe they are much simpler than those in the sale. There the problem is to set up properly on the books the assets acquired, dividing, if possible, the cost price between the assets, so as to be able to use a rate of depreciation on each class of assets rather than a composite rate.

F. A leasehold can be capitalized if it was acquired before 1913 and could have been sold on March 1, 1939, for a definite sum; or if it is acquired for cash or other consideration.

Questions Directed to Mr. Nutt

A Member: In the sale of restaurants under the installment method, what figure does the 30% apply to in order to determine whether it comes under the installment provision?

Chairman Nutt: You have got a $40,000 mortgage and a man assumes it, and the man pays $30,000 cash and another $30,000 more; that makes $100,000 as the sale price. It's the ordinary term of a sales price—30% of that $100,000. It can be comprised of cash, any mortgages assumed and any assumed by the seller. Selling fees can't be deducted like lawyers' fees; that's out of the question.

A Member: For instance, a corporation owns two restaurants and wants to sell them and save money on the installment basis. They then declare a dividend and have the stockholders sell it.

Chairman Nutt: Well, that has been tried, but without much success. There are many cases, not only with a restaurant but with a sales development, where they want to avoid the sales corporation tax and have made a liquidating dividend and then the stockholders have sold it. Unless there is an appreciable length of time to show no arrangement has been made beforehand, prior to the distribution, the government is likely to upset the whole thing.

Same Member: In other words, they would not allow it?

Chairman Nutt: I don't think so.

A Member: Would you say six months was a reasonable time?

Chairman Nutt: I would hate to. I think probably six months is probably a reasonable time, yes; not tomorrow or two months. That depends on the circumstances and on the examining officer, but I would say six months was a reasonable time.

A Member: In the sale of a restaurant, what is the procedure involved in estimating the profit where the company did not capitalize the value of the fixtures, equipment, etc., over a period of years?

Chairman Nutt: You mean the expenses?

Same Member: No, the value of the equipment. Where they have sold the restaurant. This outfit does not keep accurate records of the various transactions.

Chairman Nutt:. What did they do during the years they were in business? They had to keep some sort of records.

Same Member: They did this very inaccurately.

Chairman Nutt: If they could prove they did not deduct their capital expense—they must have taken some depreciation somewhere along the line, and set up certain values on the income tax return. I can hardly

conceive of a situation like that where a concern is doing some business. You have got to furnish a balance sheet each year.

Same Member: Well, I have run across this question. Of course, a sale has been made, and I got the account about a year ago and have found they have not kept an accurate set of books and cannot find the income tax returns for the previous years, so they cannot tell what depreciation to take.

This is my suggestion; I don't know whether you will verify it: I said he ought to get somebody to appraise the value of the fixtures and equipment.

Chairman Nutt: Well, that is good, in part.

Same Member: That would improve the purchase price.

Chairman Nutt: Is it an individual, a corporation, or what is it?

Same Member: A partnership.

Chairman Nutt: Well, returns are available in Washington to the proper person to inspect. A partner has the right to go down and inspect, or have it sent here; I don't know what the usual procedure is, but you can go into income tax returns of any one person.

The appraisal won't work unless you are able to show the man is not taking it as a benefit in his income tax return, has worked off his cost in replacement costs or charged all his replacements to expense. I would not recommend it as the best way; it is a last resort, I should say.

On the other hand, you would have to liquidate your appraisal as of the time of purchase, which is not satisfactory. I would try and get returns filed; that would be the first step I would take.

A Member: In this instance, if the restaurant was built or purchased more than ten years, there would not be any need or necessity for taking depreciation because the government, I don't think, would allow it.

Chairman Nutt: You mean just simply on the equipment, etc.?

Same Member: Yes.

Chairman Nutt: Yes, I think that's true.

A Member: You take a restaurant that has been in a certain town and they build a factory and this factory is closed down. The man who owned this restaurant had to abandon it. Can he take a complete loss on the cost of that restaurant? He's never taken any depreciation; it is just a small restaurant.

Chairman Nutt: No.

Same Member: As an abandonment?

Chairman Nutt: The fact that you take no depreciation on the return does not enter into the picture. The government will probably say it probably depreciated, whether you took it or not, and they will probably only allow you the loss as of the date of abandonment despite the fact that he did not get any depreciation on it.

There is one other quirk in there that has just crept into the Internal Revenue Law, and that is, where you have failed to take depreciation and there is a loss in that year, they do not compel you to take it. That is where depreciation does not reduce your income tax. Then in those cases where there has been an enlargement, in the last six months or something like that, in bad debts or depreciation, you would be able to get that, I think, in this new interpretation they are giving.

A Member: Did I understand you to say it might be profitable to liquidate a corporation before selling the assets?

Chairman Nutt: I would think so, because you probably would not liquidate on the same basis as you would sell it. Of course, the stockholders have to report a profit on that time. In a corporation made in a sale, you only have two taxes; first you have the corporation tax to pay on the corporation, then you have got,

in addition, the liquidation tax—what you get out of the corporation compared to what you put into it—so you have got two taxes. It is not as successful in a corporation; you have got to be guided by the circumstances in the case of corporations.

Same Member: You have got to "watch your step."

Chairman Nutt: "You bet your boots."

A Member: In the case of a restaurant, you would distinguish between equipment such as tables, etc., and improvements such as leaseholds, etc., would you not, ordinarily?

Chairman Nutt: In what respect?

Same Member: I mean, for purposes of depreciation and amortization.

Chairman Nutt: Yes; sure.

Same Member: Taking, for example, the matter of leasehold improvements. A man signs a lease for two years and he may renew it if business is good. What would be your base of amortization in that case?

Chairman Nutt: Well, two years are a short lease. The usual practice, of course, is to write off your improvements over the period of the first year, even where they have the privilege of renewal or not. Whether or not that two years are too short—what would you say about it? . . . (turning to Mr. Wunderly) . . .

Mr. Wunderly: Well, I would say two years. Say, if he does not renew in two years, it means that his business was not very good and he would write it off anyway. If he does renew in two years it means he has extra chance of making profits and he will need to write it off in five years. It would be to his advantage, then, to write it off over five years. If he writes it off over two years and does not make any money, it does not make any difference anyway.

Same Member: What I mean is, when he first opens his business he has to keep that in mind.

Automobile Dealers' Accounting

The following address was given by Mr. Alfred Wm. Oldehoff, Chairman of the Automobile Dealers' Accounting Committee, at a round-table forum held at the Engineering Auditorium, 29 West 39th Street, New York City, on November 15, 1939. The forum was called to order by Mr. Andrew Stewart, Second Vice President of the Society.

Phases of Automobile Dealer Accounting

By Alfred Wm. Oldehoff, C.P.A.

IN the presentation of this paper at the round-table forum sponsored by the Committee on Automobile Dealers' Accounting, I will discuss only those phases of accounting and accountants relations to automobile dealers as are peculiar to that branch of our practice. In this field one cannot consider only the relations of the accountant and his client, the automobile dealer, but must also take into account the relations of the dealer with his factory and his finance company. Each one of these relationships will be discussed in turn.

Relations between Dealer and Manufacturer

The dealer in automobiles has the exclusive right to sell the products of any one manufacturer in the territory assigned him in accordance with a contract or franchise from that manufacturer. In consideration of rights granted the dealer, he must assume responsibilities and obligations commensurate with the policies of the manufacturer, among which are certain financial and accounting requirements.

Most automobile manufacturers require their dealers to maintain their records in accordance with a uniform system of accounting developed and prescribed by them. All manufacturers request that monthly financial statements be submitted on forms supplied. In addition thereto, extensive statistical information is required. This data may take the form of inventories, purchases and sales figures by types of automobiles, the distribution of overhead expenses on some predetermined basis, the number of employees by departments, the basis of salesmen's commissions, the income from the sale of labor and parts per repair order, or the average reconditioning costs per used car.

The information received from the dealers by the manufacturer is used primarily for purposes of sales control, and secondarily to furnish the dealer with suggestions designed to assist him in selling automobiles and maintain financial stability. The manufacturers maintain business management departments to analyse dealers statements. The personnel of these departments are in an excellent position to make comparisons and render an excellent service to the dealers and their accountants.

Generally speaking, it is recommended that the accountant adhere strictly to the requirements of the particular manufacturer associated with his client, provided that such requirements do not vary greatly from the accepted principles of accounting. Uniformity of financial statements and accounting procedure is always helpful and makes comparison between dealerships possible. It is the duty of the accountant to

assist as far as possible in fostering the fullest co-operation between his client, the automobile dealer, and the manufacturer.

Relations between Dealer and Finance Company

The automobile dealer, in the majority of cases, operates with a capital that is insufficient to enable him to buy his cars for cash, as all cars are sold to dealers C.O.D., or sell his cars on any deferred payment plan. It is therefore the function of automobile finance companies to make it possible for the dealer to take delivery of his autos from the manufacturer and pay for them when they are sold, and also, to enable the dealer to sell the automobile and receive payment in full at the time of sale. The first function is referred to as wholesale financing and the second function is referred to as retail financing.

To the finance company, retail financing is far more lucrative than wholesale financing. In consideration for the dealer using a particular finance company when he sells an automobile on a deferred payment plan, the finance company finances the purchase of his stock cars at nominal rates.

Retail financing is of two types, recourse and no recourse. The distinction between types depends upon whether or not the dealer is asked to endorse the note of the car purchaser taken over by the finance company. The majority of retail financing is done on a recourse basis whereby the finance company can look to the dealer to pay the customers note in the event that person defaults thereon. These notes may run in some cases to twenty four months and represent the difference between the retail price of the automobile and the downpayment or trade-in plus the finance charge. The finance charge includes interest on the loan, insurance premiums for fire and theft insurance on the car, and a dealers reserve. The dealers reserve is a consideration for his endorsement of the retail note and is retained by the finance company until the note is paid up when it is refunded to the dealer. The dealer records the reserve on his books by journal entry, charging the finance company and crediting income (federal income tax regulations require that dealers include these reserves as income when the retail sale is made). Some dealers set up this amount as a reserve against possible loss from nonpayment of notes and making good on his endorsement. Losses are usually small because of the repossession of the collateral and few dealers set up such reserves.

Inventories

The principle of "cost or market, whichever is lower", holds as true with the inventories of automobile dealers as with any other kind of business.

The automobile dealer is primarily in a new car selling business and his inventory of new cars is of great importance and is usually carried at cost. However, should a dealer have new cars on hand at the time that new models come out, the accountant should consider an adjustment reflecting depreciated value due to obsolescence and change in type of car.

The used car traded-in usually represents the gross profit on the new car sold. In other words, the dealer must liquidate the used car before he can realize the full selling price of the new car. Experience has shown that a dealer sells an average of 2½ used cars before complete liquidation is obtained. When a used car is traded-in, the automobile dealer usually allows more than he expects to realize from its sale. This "overallowance" is equivalent to a rebate

or discount on the new car and should be charged against new car sales. At every accounting period, the used car inventory should be "revalued" and the depreciation charged to the cost of used cars sold or some special inventory adjustment account.

Parts, accessories, gasoline, oil and grease inventories must be frequently adjusted for variations in costing, loss from breakage, and obsolescence. Materials used on repair work in process are retained in the inventory until the work is completed and costed out.

The cost of labor applicable to repair work in process, is carried in an inventory account until the work is completed and costed out.

A perpetual inventory record should be maintained for new and used cars and the accountant serving the automobile dealer should make it his responsibility to make a physical check of this record *frequently*. Physical verification of parts and accessory inventories should be made at least twice a year while the verification of gasoline, oil and grease should be made at shorter intervals.

Internal Charges

Among the problems of the automobile dealer, is the one relating to the non-revenue operations of his business, wherein, one department supplies material and/or labor to another department. Typical examples are the servicing and delivery of new cars by the service department; the reconditioning of used cars by the service department; guarantee work on new and used cars by the service department; supplies used by new and used car salesmen; the maintenance of company owned equipment and rolling stock by the service department.

The accounting treatment of non-revenue transactions or internal charges are overlooked in small dealerships resulting in a distorted accounting picture. The necessity for absolute accuracy in recording these transactions requires that a pre-numbered repair order be prepared for every repair job whether it be for a customer or for departmental work. The costing of repair orders is restricted to prime cost (material and labor). One prominent manufacturer recommends the inclusion of other costs related to labor cost. Overhead expenses are distributed to the departments at the time of statement preparation.

The Wash-Out Sheet

As previously referred to, the automobile dealer is primarily in the new car selling business. Until he has liquidated the used car traded-in against a particular new car or the used car traded-in against the first trade-in, etc., the dealer cannot determine whether he made a profit from the sale of the new car or not. Therefore, the gross profit from the sale of the new car consists of the retail sale price less the factory delivered cost of the car, the salesman's commission, the service cost, the overallowance or loss on the sale of used cars traded-in, the salesmen's commissions on the used cars, the used car reconditioning and servicing costs, and guarantee work. One large manufacturer recommends a "wash-out" sheet designed to record with respect to each new car sold full financial data through the sale for cash of the last trade-in.

General

The automobile dealership is often referred to as the "biggest little business". There are few businesses, if any, that have the multiplicity of accounting problems. In the foregoing discussion, I have only touched on a few of the problems confronting the accountant serving the automobile dealer.

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